93-1479

No. _____

In the Supreme Court

OF THE

United States

Supreme Court, U.S.
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OCTOBER TERM, 1993

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 THROUGH 100, INCLUSIVE,
Petitioners,

VS.

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Is the rule of law affirmed by the California Supreme Court — that alleged misrepresentations that certain contracts as a whole were formalities that did not affect respondents' legal rights are sufficient under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ('FAA"), to avoid arbitration — preempted by the rule established by this Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), that "fraud in the inducement of the arbitration clause itself" must be alleged in order to avoid an order compelling arbitration under the FAA?

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CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 THROUGH 100, INCLUSIVE,
Petitioners,

VS.

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Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The orders of the Superior Court of the State of California for the County of Ventura denying the petitioners[1] motions to compel

[1]Pursuant to United States Supreme Court rule 29.1, petitioner CRUTTENDEN & COMPANY reports no parent or subsidiary corporations, petitioner TALLEY McNEIL & COMPANY, INC. reports parent corporation Cruttenden & Company and no subsidiary corporations, and petitioner SUTRO & CO., INC. reports parent corporations

arbitration are not officially reported and are reproduced in the appendix ("App.") at pages 1a-4a.[2]

The order of the Second District Court of Appeal for the State of California affirming the denial of the petitions to compel arbitration is officially reported at 18 Cal. App. 4th 802 (1993) and is reproduced in the appendix at page 5a.

The order of the California Supreme Court denying the petition for writ of certiorari is not officially reported and is reproduced in the appendix at page 14a.

JURISDICTION

The order of the California Supreme Court denying the petitioners' petition for writ of certiorari was rendered on December 16, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

STATUTE INVOLVED

Sections 2 and 4 of the FAA, 9 U.S.C. §§ 2 & 4, are reproduced as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to

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John Hancock Freedom Securities, Inc. and John Hancock Mutual Life Insurance Co. and no subsidiary corporations.

[2]Originally, petitioners CRUTTENDEN & COMPANY and TALLEY McNEIL & COMPANY, INC. (collectively "Cruttenden") and petitioner SUTRO & CO., INC. ("Sutro") brought separate motions to compel arbitration (Superior Court of California, County of Ventura Case No. 119524). Petitioners then brought separate appeals which were consolidated for argument (Court of Appeal of California, Second Appellate Court District Case Nos. B065193 & B066610). Cruttenden and Sutro then brought a joint petition for writ of certiorari to the California Supreme Court (Case No. S035471).

> arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation any contract.

9 U.S.C. § 2 (1982).

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

9 U.S.C. § 4 (1982).

STATEMENT OF THE CASE

A. FACTS.

The respondents, ROBERT A. LYNCH and BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979 ("respondents"), alleged, in part, securities fraud and breaches of fiduciary duty against the petitioners, securities brokerage firms and their employee, in the handling of their securities accounts. Throughout the life of the respondents' securities accounts at Sutro and then Cruttenden, the respondents signed 12 separate documents, each containing an agreement to arbitrate disputes concerning their accounts. Many of the arbitration clauses signed by the respondents were written in bold print and were positioned immediately before the signature lines where the respondents signed their names.

To avoid their contractual obligation to arbitrate, the respondents alleged in their complaint and in declarations in opposition to motions to compel arbitration: (1) that they were told they were signing agreements which did not affect their legal rights, (2) that they were not informed of the arbitration clauses, and (3) that they did not read the agreements before they signed them.

B. PROCEDURE.

The petitioners sought to compel arbitration based upon the FAA. Portions of the motions to compel arbitration indicating reliance upon the FAA are reproduced in the appendix at pages 15a-19a and 20a-23a. While the state courts of first instance recognized the conflict between state appellate courts' and federal appellate courts' interpretations of the FAA, they, nevertheless, felt that the state rule mandated the denial of the motions to compel arbitration. Portions of the transcripts of the hearings before the trial courts, which indicate the awareness of this conflict between the state and the federal rules are reproduced in the appendix at pages 24a-26a and 27a-42a.

The petitioners then argued before the Second District Court of Appeal that the interpretation of the FAA as set forth in this Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), controlled and preempted any contrary state rules. The portions of the petitioners' briefs filed with the District Court of Appeal raising the federal question are reproduced in the appendix at pages 44a-48a and 49a-54a. The Second District Court of Appeal, however, distinguished the federal cases, applied California law and affirmed the trial courts' denial of the petitions to compel arbitration.

The petitioners then joined in a petition for review to the California Supreme Court, again raising the argument that the state court cases were in conflict with federal cases interpreting the FAA and were, thus, preempted. Review was denied. The portions of the petition for review to the California Supreme Court raising the preemption issue are reproduced in the appendix at pages 55a-61a.

ARGUMENT

I.

REVIEW SHOULD BE GRANTED BECAUSE THE CALIFORNIA SUPREME COURT HAS DENIED ARBITRATION UNDER THE FAA IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT, THE UNITED STATES COURTS OF APPEALS, AND OTHER STATE COURTS OF LAST RESORT.

A. THIS COURT HAS INTERPRETED THE FAA TO LIMIT JUDICIAL FACT-FINDING TO ALLEGATIONS OF FRAUD DIRECTED SPECIFICALLY TO AN ARBITRATION CLAUSE AND REJECTED JUDICIAL INTERVENTION BASED UPON ALLEGATIONS OF FRAUD IN THE INDUCEMENT OF THE CONTRACT GENERALLY.

This Court provided the rule which governs this petition in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967). In that case, the Court considered whether the issue of the enforceability of a contract alleged to have been fraudulently induced and which contained an arbitration provision was to be considered by a court or by arbitrators. The Court ruled that the matter was to be sent to arbitration. In so holding, the Court recognized that the arbitration clause is severable from the rest of the contract. The Court held:

> [I]f the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the "making" of the agreement to arbitrate — the federal court may proceed to adjudicate it. *But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.*

Id. at 403-04 (emphasis added).

As is demonstrated in the following sections, the *Prima Paint* rule has been uniformly applied throughout the federal system. Challenges to contracts, such as those in the present case, which

are not specific to the arbitration clause must be compelled to arbitration under the FAA.

B. THE UNITED STATES COURTS OF APPEALS AND NUMEROUS STATE COURTS OF LAST RESORT HAVE REJECTED ATTEMPTS TO UNDERMINE THE *PRIMA PAINT* DOCTRINE.

Federal Circuit Courts of Appeals have preserved the distinction between generalized allegations of fraud directed to the entire contract and those challenges directed specifically to the arbitration clause. The Ninth Circuit repeatedly has ruled that in order for a "fraud in the inducement" challenge to be heard in court rather than in arbitration, the challenge must be "*separate* and *distinct* from any challenge to the underlying contract." *Teledyne, Inc. v. Kone Corp,*. 892 F.2d 1404, 1410 (9th Cir. 1990). In *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.,* 925 F.2d 1136 (9th Cir. 1991), the court said of the *Prima Paint* doctrine: "Under this analysis, a federal court may consider a defense of fraud in the inducement of a contract only if the fraud relates *specifically* to the arbitration clause itself *and not to the contract generally*." *Id.* at 1140 (emphasis added).

The other federal circuit courts of appeals are in accord with the Ninth Circuit's interpretation of *Prima Paint* and, thus, are contrary to the resolution of the issue reached by the California courts in the present case. In *Bhatia v. Johnston*, 818 F.2d 418 (5th Cir. 1987), for instance, a securities customer alleged in his complaint and in declarations in opposition to a motion to compel arbitration that he signed a customer agreement containing an arbitration clause at the instruction of his broker, that the broker did not explain the significance of the arbitration clause, and that the broker did not explain that the customer's legal rights under the agreement were different than they were under a previous agreement. *Id.* at 422 nn.4 & 5. The Fifth Circuit said of these allegations: "We are persuaded that Bhatia did not assert that the arbitration clause alone, as opposed to the customer agreement generally, was induced by the misrepresentations and actions of Johnston." *Id.* at 422.

The Seventh Circuit, in *Schacht v. Beacon Ins. Co.*, 742 F.2d 386 (7th Cir. 1984), emphasized that the "fraud in the inducement" challenge must refer solely to the arbitration clause in order to bypass arbitration:

> Appellant nowhere contends that the alleged fraud in the inducement applied *solely* to the arbitration clause. Its claim of fraud applies equally to all provisions of the contract. Thus, if the clause is sufficiently broad to encompass a claim of fraud in the inducement, the district court properly concluded that *Prima Paint* precludes the court from addressing that claim.

Id. at 390. *See also Union Mut. Stock Life Ins. Co. of Am. v. Beneficial Life Ins. Co.*, 774 F.2d 524, 528 (1st Cir. 1985) ("[t]here must be an independent challenge to the making of an arbitration clause"); *Hamilton Life Ins. Co. of N.Y., vs. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 610 (2d Cir. 1969) ("[i]llegality, fraudulent inducement, or repudiation of the principal contract does *not* operate to nullify an agreement to arbitrate"); *Statement Mach. Co. v. Alperin*, 591 F.2d 234, 238 (3d Cir. 1979); *Jeske v. Brooks*, 875 F.2d 71, 75 (4th Cir. 1989) ("[b]ecause the alleged defects pertain to the entire contract, rather than specifically to the arbitration clause, they are properly left to the arbitrator for resolution"); *Arnold v. The Arnold Corp.*, 920 F.2d 1269, 1278 (6th Cir. 1990) ("[t]he question presented . . . is . . . whether the . . . complaint contains a . . . claim of fraud in the inducement of the arbitration clause itself, *standing apart from the whole agreement* . . .); *N&D Fashions, Inc. v. DHJ Indus, Inc.*, 548 F.2d 722, 728 (8th Cir. 1977) ("[a]t most, N&D claims fraud in the inducement to enter the contract of sale, rather than fraud in the inducement to enter the agreement to arbitrate. Fraud of the first type does not affect the duty to arbitrate"); *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953, 960 (10th Cir.), *cert. denied*, 121 L. Ed. 2d 584 (1992) ("[a] plaintiff seeking to avoid a choice provision . . . must . . . plead fraud going to the specific provision"); *Miller v. Drexel Burnham Lambert Inc.*, 791 F.2d 850, 854 (11th Cir. 1986) ("[a]ppellant's claim bars arbitration only if it goes to the arbitration clause itself and not the whole contract").

While not as uniform in following the dictates of *Prima Paint* as the Circuit Courts of Appeals, many state courts of last resort likewise have rejected attempts similar to those presented in the present case to avoid contractual arbitration. In *Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 604 So.2d 332 (Sup. Ct. Ala. 1991), the Supreme Court of Alabama noted that allowing allegations that a brokerage firm mailed a contract to its customer for signature without an explanation that the contract contained an arbitration clause to defeat a motion to compel arbitration would, in every case, allow "a skillfully crafted complaint" to avoid arbitration, "thus effectively eviscerating the FAA and circumventing the strong policy favoring arbitration." *Id.* at 336. *See also South Carolina Pub. Serv. Auth. v. Great W. Coal, Inc.*, 437 S.E.2d 22 (Sup. Ct. S.C. 1993); *Capital Income Properties-LXXX, et al. v. The Honorable Robert M. Blackmon*, 843 S.W.2d 22 (Sup. Ct. Tx. 1992); *Hercules & Co. v. Shama Restaurant Corp.* 613 A.2d 916 (D.C. Ct. App. 1992); *Vukasin v. D.A. Davidson & Co.*, 241 Mont. 126 (Sup. Ct. Mont. 1990); *Sentry Sys., Inc. v. Guy*, 98 Nev. 507 (Sup. Ct. Nev. 1982); *David v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 440 N.W.2d 269 (Sup. Ct. N.D. 1989).[3]

All of the federal appellate courts and many state courts of last resort, therefore, follow *Prima Paint* in requiring a "fraud in the inducement" challenge to arbitration to be directed specifically and solely to the arbitration clause in order to defeat a motion to compel arbitration.

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[3] Other state courts of last resort, like the California Supreme Court, recognize exceptions to the *Prima Paint* doctrine in cases under the FAA for allegations of fraud in the inducement which refer to the contract generally rather than to the arbitration clause specifically. *See, e.g., In the Matter of the Arbitration Between Weinrott and Carp*, 32 N.Y.2d 190, 197 (Ct. App. N.Y. 1973) ("if the alleged fraud was part of a grand scheme that permeated the entire contract, including the arbitration provision, the arbitration provision should fall with the rest of the contract"); *Thayer v. American Fin. Adviser, Inc.*, 322 N.W.2d 599 (Sup. Ct. Minn. 1982) (language of the arbitration clause must indicate a specific intent to arbitrate fraudulent inducement claim).

C. THE OPINION IN THE CASE BELOW IMPROPERLY DENIES ARBITRATION UNDER THE FAA BASED UPON GENERALIZED ALLEGATIONS OF FRAUDULENT INDUCEMENT OF THE CONTRACTS AS A WHOLE, NOT FRAUD CLAIMS DIRECTED SPECIFICALLY TO THE ARBITRATION CLAUSES.

In responding to the petitioners' motions to compel arbitration below, the respondents made allegations concerning the circumstances surrounding their signing the agreements containing arbitration clauses. None of these allegations satisfy *Prima Paint*. A review of the respondents' references to the signing of the documents which were presented below indicates that all but one of the references unambiguously apply to the agreements generally, not to the arbitration clauses specifically. The only allegation which arguably could be interpreted to be specific to the arbitration clauses in either the complaint or the declarations is the allegation that the broker did not reveal the arbitration provisions to the respondents ("[t]he Lynches claimed they were not advised of the contents of the documents . . ."). (App., 6a-7a.) As is demonstrated below, however, the failure of the respondents to read their documents is not grounds to void the contracts.

All remaining allegations relating to fraud in the execution of the agreements refer to the contracts generally. *E.g.*, "MR. CARTY . . . told us . . . that he needed some 'form' documents signed in order to open the account. . . . He told me . . . that it was not necessary to read the documents since they simply effected an opening of the account. . ."; "MR. CARTY told me that they were simply forms . . . needed . . . for the continuing management of our family funds . . ."; "MR. CARTY repeatedly told us that any document papers were . . . so that he could 'manage our money'." (App., 6a-7a.)

These are all comments that, on their face, refer to the making of the contract generally, not the arbitration clause specifically. As such, they should have been compelled to arbitration under the *Prima Paint* doctrine.

1. Contrary to the Position of the California Courts, the Circuit Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegations of a Failure to Read the Contract.

Underlying the respondents' claims of fraud in the inducement of the contract is the admitted fact that they did not read the 12 contracts containing arbitration clauses before they signed them. Of this admitted failure to read the contracts, the California Court of Appeal, in *Lynch v. Cruttenden & Co.*, 18 Cal. App. 4th 802, 22 Cal. Rptr 2d 636 (1993) (App., 8a-9a), wrote:

> The general rule in California is that even in the absence of a fiduciary relationship plaintiff's failure to read a contract is excusable where reliance is placed on the misrepresentations of the other party.

Id. at 807, 22 Cal. Rptr. 2d at 639 (App., 8a-9a). The *Lynch* court relied upon prior California state court decisions to assert that this general rule is particularly applicable in cases where the plaintiff is unfamiliar with stockbrokerage documents and "is deceived as to the nature and effect of the documents." *Id.*

Many well-reasoned cases of the United States Courts of Appeals, however, have reviewed the circumstances under which a party may be excused from reading a contract and have reached precisely the opposite result.[4] The Ninth Circuit, in *Cohen v.*

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[4]Indeed, California state courts themselves seem to belie the *Lynch* court's interpretation of the general rule in California. *See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 286, 6 Cal. Rptr. 2d 20, 24 (1992) ("[r]easonable diligence requires the reading of a contract before signing it. A party cannot use his own lack of diligence to avoid an arbitration agreement"); *Macaulay v. Norlander*, 12 Cal. App. 4th 1, 6, 15 Cal. Rptr. 2d 204, 207 (1992) ("[r]espondents . . . were bound by the provisions of the client agreement whether they read it or were aware of the arbitration clause when they signed the document"); *Parr v. Superior Court*, 139 Cal. App. 3d 440, 445-46, 188 Cal. Rptr. 801, 804 (1983) ("[a]t the same time, that very person, whether in fact he had read it or not, could choose alternatively to seek arbitration, or, should he prefer, to perform and receive the benefits of the contract . . ."); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d

Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988), recognized that, despite allegations of misrepresentations:

> We see no unfairness in expecting parties to read contracts before they sign them..... We therefore hold that allegations of misrepresentations directly contrary to the specific and unambiguous terms of a written arbitration agreement do not, *as a matter of law*, state a claim for fraud..... *Whether the Cohens read the agreement but did not notice the arbitration clause, or chose not to read the agreement at all, their reliance on Wedbush's alleged misrepresentations was unreasonable* in light of the clear and explicit language of the contract.

Id. at 287-88 (emphasis added).

In *Perez & Assoc. v. Welch*, 960 F.2d 534, 538 (5th Cir. 1992), the court noted that two customers of a securities broker signed customer agreements containing arbitration clauses without first reading the documents. This did not allow these customers to bypass contractual arbitration.

Likewise, in *Pierson v. Dean Witter Reynolds Inc.*, 742 F.2d 334, 339 (7th Cir. 1984), the court ruled that the failure to read a brokerage contract cannot be used to avoid the consequences of an arbitration clause contained in that contract.

Federal courts interpreting the FAA, therefore, have reached a conclusion directly contrary to that reached by the California courts in the present case.

668, 672, 97 Cal. Rptr. 811, 813 (1971) (court enforced arbitration agreement despite assumption for argument's sake that it was "adhesory").

2. Contrary to the Position of the California Courts, the United States Courts of Appeals Reject Challenges to Arbitration Based Upon the Allegation that the Broker Advised that the Contract Was a Mere Formality that Would Not Affect Legal Rights and Did Not Advise of the Existence of the Arbitration Clause.

Of the respondents' allegations that they were advised that the account documents were a "mere formality" and that they were not told that the documents contained arbitration clauses, the *Lynch* court wrote:

> [W]e fail to see why a representation that signing a document will not affect the Lynches [sic] rights, cannot fairly be characterized as fraud going directly as to the arbitration clause, a clause that clearly affects the Lynches' rights.
>
> * * *
>
> The alleged representation, that the documents were a formality and did not affect the rights of the Lynches, was tantamount to a representation that the documents contained no arbitration clause.

18 Cal. App. 4th at 809-10, 22 Cal. Rptr. at 640-41 (App., 10a-11a).[5]

The Ninth Circuit in *Cohen*, however, squarely rejected an assertion similar to that relied upon by the *Lynch* court that a representation that the agreement does not affect legal rights is "tantamount" to fraud aimed directly at the arbitration clause. *Cohen*, 841 F.2d at 287. On the same issue, the Ninth Circuit held in *Cohen*:

> The Cohens' other allegation in support of the claim of fraud is that they were "advised, either expressly or implicitly . . . that [the margin agreement] did not compromise any of

---

[5]The *Lynch* court also attempted to distinguish the *Cohen* decision upon the grounds that there was no fiduciary relationship alleged in *Cohen* as there was in *Lynch*. The effect of the fiduciary duty allegations upon the rule in *Prima Paint* is discussed in detail in Section D *infra*.

> [their] rights." ... [T]he alleged statement here cannot fairly be characterized as fraud in the inducement as to the *arbitration* clause. The statement is quite general, relating to the contract as a whole rather than to the arbitration clause in particular. Indeed, the Cohens complain that nothing at all was said about the abritration clause. Because the Cohens have not raised a challenge to the validity of the arbitration clause itself, this issue is subject to mandatory arbitration.

Id. at 287.

The federal court interpreting the FAA, therefore, reached a conclusion directly contrary to that reached by the California courts in the present case.

3. Contrary to the Position of the California Courts, the United States Courts of Appeals Have Rejected the Notion that Allegations of Fraud in the Inducement Can be Directed at Both the Arbitration Clause and the Contract As A Whole.

The *Lynch* court characterized allegations of fraud in the inducement of a contract generally as follows:

> That the misrepresentation may go to some or even all of the clauses of the contract as well as the arbitration clause does not mean that fraud in the making of agreement for arbitration is not in issue. *Prima Paint* does not stand for the proposition that a fraudulently induced arbitration agreement becomes valid and enforceable if the fraud also goes to other parts of the contract.

18 Cal. App. 4th at 810, 22 Cal. Rptr. 2d at 641.

Federal courts, however, hold that *Prima Paint* stands precisely for the proposition that fraud which goes to portions of the contract in addition to the arbitration clause must be compelled to arbitration.

In *Arnold v. Arnold*, 920 F.2d 1269 (6th Cir. 1990), the court provided the following interpretation of the *Prima Paint* doctrine:

> The question presented by the present case is thus whether the amended complaint contains a well-founded claim of

> fraud in the inducement of the arbitration clause itself, *standing apart from the whole agreement*, that would provide grounds for the revocation of the agreement to arbitrate.

Id. at 1278. *See also Sweet Dreams Unlimited v. Dial-A-Mattress Int'l*, 1F.3d 639, 641 n.4 (7th Cir. 1993) ("[a] court may consider a claim that a contracting party was fraudulently induced to include an arbitration provision in the agreement but not claims that the entire contract was the product of fraud").

Likewise, the Ninth Circuit has rejected reasoning similar to that of the *Lynch* court that allegations of fraud in the inducement may be directed both at the contract generally and at the arbitration clause and still bypass arbitration. *Kone*, 892 F.2d at 1410; *Three Valleys*, 925 F.2d at 1140.

The California courts, therefore, refused to compel arbitration of the present allegations in contravention of the controlling federal precedent.

D. ALLEGATIONS OF A FIDUCIARY RELATIONSHIP DO NOT JUSTIFY THE COURT'S DEPARTURE FROM *PRIMA PAINT* DOCTRINE IN THE ABSENCE OF EXTRAORDINARY ABUSES OF THE RELATIONSHIP.

The California Court of Appeal attempted to distinguish the facts before it from those in applicable federal cases by asserting that the respondents' allegation of a preexisting fiduciary duty with the broker justified their failure to read their contracts before signing them. The only factual allegation the respondents offered, however, to support the alleged existence of a fiduciary duty was that the broker secured the trust and confidence of the respondents before asking them to sign the customer agreements. (App., 6a-7a.) The same type of allegation did not preclude arbitration under the FAA in *Perez & Assoc. v. Welch*, 960 F.2d 534, 538 (5th Cir. 1992). In that case, two custmers of securities broker-dealers complained that they signed customer agreements without reading them or understanding that they contained arbitration clauses because they "trusted" the broker. Because that trust led them to execute the entire contract, however, and not just the

arbitration clause, the issue of breach of fiduciary duty itself was referred to arbitration.

In *Bhatia v. Johnston*, 818 F.2d 418 (5th Cir. 1987), the fact that the broker and the customer had a preexisting relationship at another brokerage firm did not excuse arbitration even though the customer alleged that the broker misrepresented the terms of the new customer agreement to him.

Likewise, the Supreme Court of Alabama considered whether allegations by a brokerage customer of fraud in the inducement of the contract containing an arbitration clause mandate a hearing by the court when they are combined with the allegation that the broker owed a fiduciary duty to disclose the existence of the arbitration clause. That court refused to allow such allegations to defeat contractual arbitration under the FAA:

> The plaintiff contends that the "central issue in this case is whether Merrill Lynch owed a duty to [her] to disclose the . . . material facts regarding the arbitration agreement." . . . The omission to do so, the argument goes, constituted fraud in the making of the arbitration clause itself. We also reject that argument because Mrs. Jones' claim of breach of fiduciary duty to disclose material facts applies as cogently to all of their claims as to the arbitration clause itself.

Jones v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 604 So.2d 332, 338 (Sup. Ct. Ala. 1991). *See also Capital Income Properties-LXXX v. The Honorable R. Blackmon*, 843 S.W.2d 22, 23 (Sup. Ct. Tex. 1992) ("[a] claim of fraud in the inducement, unless specifically directed to the making of the arbitration clause, does not defeat application of that clause to the agreement as a whole").

The California courts, therefore, refused to compel arbitration for reasons directly contradicted by holdings of the federal courts and other state courts of last resort.

E. THERE IS NO DISPUTE THAT FEDERAL LAW CONTROLS THE ISSUES DECIDED IN THE CASE BELOW AND PREEMPTS CONFLICTING STATE LAW.

There is no dispute that the present controversy is governed by the FAA *See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), which provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §§ 1 & 2 (1982); *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 475 (9th Cir.), *cert. denied*, 117 L. Ed. 2d 516 (1991). As the transactions in the respondents' accounts involved national securities exchanges, they were performed under contracts evidencing transactions involving commerce. *Cohen*, 841 F.2d at 284; *Macchiavelli v. Shearson, Hammill & Co.*, 384 F. Supp. 21, 30 (E.D. Cal. 1974).

Both state and federal courts recognize that on issues of arbitration stemming from contracts governed by the FAA, federal law preempts conflicting state law. *Southland Corp. v. Keating*, 465 U.S. 1, 13, 104 S. Ct. 852, 79 L. Ed. 2d 1, 13 (1984); *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985). As this Court itself has decreed, the pronouncement of a federal court on the FAA supersedes any contrary state law *Volt Info. Sys. Inc. v. Board of Trustees of the Leland Standford Junior Univ.*, 489 U.S. 468, 477, 103 L. Ed. 2d 488, 499 (1989) ("state law may nonetheless be preempted *to the extent that it actually conflicts with federal law*' ") (emphasis added).

The federal preemption doctrine has been applied to the exclusion of contrary state interpretations of Section 2 of the FAA, which was relied upon by the California courts below:

> Section 2 [of the FAA] is a Congressional declaration of a liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to*

> *the contrary*. The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.... [T]he Courts of Appeals have ... consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration, *whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability*.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 103 S. Ct. 927, 941, 74 L. Ed. 2d 765, 785 (1983) (emphasis added).

Thus, it is clear that where the federal courts have spoken on issues under the FAA, that law controls both in state and federal courts. *(See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984) (California Supreme Court overruled); *Perry v. Thomas*, 482 U.S. 483, 489, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (California statute preempted). Because the federal courts have explicitly and uniformly ruled that allegations such as those raised below must be compelled to arbitration, the California courts were bound to follow that federal precedent.

II.

REVIEW SHOULD BE GRANTED BECAUSE THE DECISION BELOW DEPARTS FROM AND SUBSTANTIALLY UNDERMINES THIS COURT'S STRONG ENDORSEMENT OF SECURITIES ARBITRATION.

This petition should be granted for an additional and equally important reason — the opinion below and the prior California state court opinions upon which it relies create a loophole in the alternative dispute resolution process relied upon by the brokerage industry and strongly endorsed by this Court. Unless this Court grants review, the California courts are likely to continue to undermine this Court's policy favoring arbitration and to broaden

California's articulation of policies directly conflicting with federal courts' interpretation of federal law.

Despite this Court's clear articulation of a policy favoring arbitration, the California courts have issued opinions interpreting the FAA in a manner which permits individuals to defeat arbitration by generalized allegations of fiduciary nondisclosure combined with admitted failures to read contracts. The decision below goes farther than any prior California decision in undermining federal policy. Read broadly, it suggests that a client of a brokerage firm can fail to read a contract, can ignore bold-faced, highlighted clauses in the contract, can ask no questions of his broker, and can nonetheless avoid a clear contractual provision providing for arbitration merely by claiming that he relied upon the broker as a "fiduciary" and was told the contract was a "formality."

Federal policy is directly to the contrary, requiring that all doubts be resolved in favor of ordering — not denying — arbitration. Indeed, this Court itself has strongly endorsed arbitration of disputes between brokerage firms and its customers, sweeping away prior decisions founded largely upon a mistrust of arbitration as a proper forum for the enforcement of customers' rights. *See, e.g., Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985); *McMahon*; and *Rodriguez de Quijas v. Shearson/American Express Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989).

This Court's statement of policy in favor of arbitration relies, in part, upon the inherent fairness of arbitration and the oversight of the industry arbitration rules and procedures by the Securities and Exchange Commission. *See, e.g., McMahon*, 482 U.S. at 233-34.

The decision below is inconsistent with the federal policies articulated in these cases. It creates a convenient road map for a plaintiff intent on avoiding arbitration and essentially says that an arbitrator is incapable of deciding threshold issues of fiduciary fraud or misrepresentation. It turns the advantage of arbitration on its head by burdening the courts with deciding threshold factual issues concerning the entry into agreements. A better and more efficient policy is to let arbitrators decide whether genera-

lized fraud claims are sufficient to release a claimant from an arbitration obligation or whether a claimant's acceptance of contractual benefits from a brokerage firm for months or years at a time constitutes acceptance of all terms of the governing contract.

CONCLUSION

For these reasons, petitioners request that this Court accept this matter for review.

Dated: March 14, 1994

Respectfully submitted,

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CRUTTENDEN & COMPANY, TALLEY
MCNEIL & COMPANY, INC., AND
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Attorneys for Petitioner
Sutro & Co., Inc.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA
LAW & MOTION MINUTE ORDER
HON. EDWIN M. OSBORNE

Reporter: R. JEFFREY
Clerk: BARBARA GALLISON
Bailiff: DOUGLAS BENTLEY
For: 2/19/92 Wednesday Dept: 43

5. 3:30 PM Case No: 119524

ROBERT A. LYNCH

VS.

CRUTTENDEN & COMPANY

Addl Info:
Filing Date: 12/27/91
Case: FRAUD
At Issue: 00/00/00
Trial:
Event: [D] MOTION TO COMPEL ARBITRATION & STAY PROCEEDINGS (CRUTTENDEN & CO., TALLEY McNEIL & CO. INC. & ROBERT CARTY JR.)

Plntff: LYNCH, ROBERT A. TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: P. GOLDENRING & GOLDENRING
Plntff: LYNCH, BETTY LAVERNE TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: P. GOLDENRING & GOLDENRING
Defndt: CRUTTENDEN & COMPANY	Atty: KEESAL YOUNG & LOGAN
Defndt: TALLEY MCNEIL & COMPANY INC.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUTRO & CO. INC.	
Defndt: CARTY JR., ROBERT C.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUN LIFE ASSURANCE COMPANY OF CAN	DAWN M. SCHOK
Defndt: LOOMIS SAYLES & CO.	

☐ Courts Motion ☐ Moving Party Request ☐ Stipulation
☐ OFF CALENDAR ☐ No Appearance ☐ No Proof of Service
☐ CONTINUED TO: __/__/__ at_____ p.m. in courtroom _____,
Judge _____
_____LMI

☑ MOTION(S) are submitted ☑ with ☐ without argument.

☑ MOTION(S): ☐ GRANTED ☑ DENIED IN ITS ENTIRETY
☐ WITHOUT PREJUDG ☐ SUBMITTED

☐ PURSUANT TO THE FORMAL ORDER NOW SIGNED BY THE COURT

☐ DEMURRER: ☐ OVERRULED ☐ SUSTAINED on grounds

_____

_____

_____

☐ Pltf ☐ Deft ☐ _____ is granted ____ days leave within which to ☐ amend ☐ answer.

☐ _____

_____

_____

_____

_____

☐ Notice waived. ☑ Counsel for ☑ Pltf ☐ Deft ☐ _____ is directed to ☑ give notice. ☐ prepare and serve a formal order.

SHEILA GONZALEZ, Superior Court
Executive Officer and Clerk

By: Barbara Gallison
Deputy Clerk

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA
LAW & MOTION MINUTE ORDER
HON. STEVEN Z. PERREN

Reporter: Sharon Lewis
Clerk: Julie Camacho
Bailiff: M. Hanks
For: 3/12/92 Thursday Dept. 30
4. 3:30 P.M. Case No. 119524

ROBERT A. LYNCH

VS.

CRUTTENDEN & COMPANY

Addl Info: Filing Date: 12/27/91
Case: FRAUD At Issue: 00/00/00
Trial:
Event: [D] MOTION TO COMPEL ARBITRATION AND MTN TO STAY FURTHER PROCEEDINGS IN THIS ACTION (SUTRO & CO. INC.)

Plntff: LYNCH, ROBERT A. TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: PETER GOLDENRING & GOLDENRING
Plntff: LYNCH, BETTY LAVERNE TRSTEE: LYNCH FAMILY TRUST DATED 05-30-79	ATTY: GOLDENRING & GOLDENRING
Defndt: CRUTTENDEN & COMPANY	Atty: KEESAL YOUNG & LOGAN
Defndt: TALLEY MCNEIL & COMPANY INC.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUTRO & CO. INC.	Atty: GILBERT R. SEROTA
Defndt: CARTY JR., ROBERT C.	Atty: KEESAL YOUNG & LOGAN
Defndt: SUN LIFE ASSURANCE COMPANY OF CAN	
Defendt: LOOMIS SAYLES & CO.	

☐ Courts Motion ☐ Moving Party Request ☐ Stipulation
☐ OFF CALENDAR ☐ No Appearance ☐ No Proof of Service
☐ CONTINUED TO: __/__/__ at____ p.m. in courtroom _____,
Judge _____
_____LMI

☑ MOTION(S) are submitted ☑ with ☐ without argument.
☑ MOTION(S): ☐ GRANTED ☑ DENIED
☐ WITHOUT PREJUDG ☐ SUBMITTED

☐ PURSUANT TO THE FORMAL ORDER NOW SIGNED BY THE COURT

☐ DEMURRER: ☐ OVERRULED ☐ SUSTAINED on grounds

_____

_____

_____

☐ Pltf ☐ Deft ☐ _____ is granted ____ days leave within which to ☐ amend ☐ answer.

☐ _____

_____

_____

_____

_____

☐ Notice waived. ☑ Counsel for ☑ Pltf ☐ Deft ☐ _____ is directed to ☑ give notice. ☐ prepare and serve a formal order.

SHEILA GONZALEZ, Superior Court
Executive Officer and Clerk

BY: JULIE CAMACHO
Deputy Clerk

COURT OF APPEAL OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION SIX
2ND CASE of Level 1 printed in FULL format.

ROBERT A. LYNCH et al.,
Plaintiffs and Respondents,
v.
CRUTTENDEN & COMPANY et al.,
Defendants and Appellants.
Nos. B065198, B066610
18 Cal. App. 4th 802; 1993 Cal. App.
LEXIS 912; 22 Cal. Rptr. 2d 636; 93 Cal. Daily Op.
Service 6712; 93 Daily Journal DAR 11395

September 2, 1993, Filed

NOTICE: [*1] THE LEXIS PAGINATION OF THIS DOCUMENT IS SUBJECT TO CHANGE PENDING RELEASE OF THE FINAL PUBLISHED VERSION.

SUBSEQUENT HISTORY: Review Denied December 16, 1993, Reported at: *1993 Cal. LEXIS 6481.*

PRIOR HISTORY: Superior Court County of Ventura. Super. Ct. No. 119524. Hons. Edwin M. Osborne and Steven Z. Perren, Judges.

COUNSEL: Howard, Rice, Nemerovski, Canady, Robertson & Falk, and Gilbert R. Serota and John M. Chaisson for Defendants and Appellants Sutro & Co., Inc.

Keesal, Young & Logan, Dawn M. Schock and John R. Loftus for Defendants and Appellants Cruttenden & Company and Talley McNeil & Company, Inc. and Robert C. Carty, Jr.

Goldenring and Goldenring and Peter A. Goldenring for Plaintiffs and Respondents.

JUDGES: GILBERT, Acting P.J.; YEGAN, J., and WILLARD, J., *concurring.

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* Retired judge of the superior court sitting under assignment by the Chairperson of the Judicial Council.

OPINION BY: GILBERT

OPINION:
GILBERT, Acting P.J.:

This consolidated appeal concerns the denial of two motions to compel arbitration made in the same case. We hold that the plaintiffs' allegations of fraud are sufficient to support the denial of the motions, and that the denial does not conflict with *Prima Paint Corp. v. Flood & Conklin (1967) 388 U.S. 395, 18 L. Ed. 2d 1270, 87 S. Ct. 1801.*

FACTS

Robert and Betty Lynch filed an action [*2] against Cruttenden & Company, Talley McNeil & Company, Robert C. Carty (hereinafter collectively "Cruttenden") and Sutro & Co. The complaint alleged that Carty, a licensed securities broker, acted as the agent of and in conspiracy with Cruttenden and Sutro, licensed brokerage houses, to defraud the Lynches by taking excessive fees.

The complaint states that the Lynches became personal friends of Carty in 1989. Carty encouraged them to have trust and confidence in him and to rely on him for financial advice. The Lynches opened accounts with Cruttenden and Sutro through Carty and transferred money to the defendants. Carty instructed the Lynches to sign various documents from time to time. He told the Lynches the documents were "... necessary to effect the continuing reliance and trust by [the Lynches in Carty and the other defendants], and that the documents did not affect legal rights and it was not necessary that they be read." The Lynches also alleged Carty told them the documents were necessary to open accounts and were only a formality. The Lynches claimed they were not advised of the contents of the documents and were not provided "... any substantial opportunity to read" [*3] them.

Cruttenden and Sutro responded by making separate motions to compel arbitration. Attached to the moving papers were various documents purportedly signed by the Lynches. The documents contained arbitration clauses in bold type requiring the

parties to submit disputes to arbitration before the National Association of Securities Dealers, Inc. or the New York Stock Exchange.

The Lynches filed affidavits in opposition to the motions. Robert Lynch declared that he attended school only to the ninth grade. Prior to meeting Carty he never had a securities account and never executed stockbroker or brokerage house agreements. Lynch first met Carty in 1988. Carty manipulated Lynch into believing Carty was a very close friend and confidante. At the beginning Carty did not mention managing Lynch's money, but spent considerable time befriending him, visiting him at his home or office as often as twice a week. In the course of the developing friendship Lynch told Carty that he owned a cement business he built from scratch. Lynch said that he was considering selling the business and investing the proceeds for retirement and for his children.

Eventually the Lynches sold the business for $5,000,000. [*4] They wanted to invest what remained after taxes and Carty asked the Lynches to allow him to manage the funds. Lynch said he had no experience with stocks. Carty told Lynch repeatedly that he should trust him and rely on his expertise and management skills.

Carty told Lynch that documents he was asked to sign were " 'standard' " and a " 'formality.' " Carty specifically discouraged Lynch from reading the documents, repeatedly referring to their friendship and the level of trust that had developed. At no time was Lynch told that the documents were contracts or that they contained an arbitration clause or otherwise limited their rights.

Lynch declared that as result of churning and mismanagement by Carty and the other defendants, the Lynches' funds have been reduced by well over half while defendants earned approximately $1,000,000 in commissions. An affidavit submitted by Betty Lynch affirmed her husband's declarations.

The trial court separately denied each motion and the moving parties appealed.

DISCUSSION

Our task on appeal is simply to determine whether the plaintiffs have alleged in their complaint and affidavits sufficient facts to warrant a trial on the validity of the arbitration [*5] agreement. (See *Strotz v. Dean Witter Reynolds, Inc. (1990) 223 Cal. App. 3d 208, 211272 Cal. Rptr. 680, fn. 2.)*

The Federal Arbitration Act provides that a written arbitration provision in a contract involving commerce is valid and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." *(9 U.S.C. § 2.)* Of course, it is well recognized that fraud may be a ground for the revocation of a contract. (See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 392, p. 356; Rest.2d Contracts, § 7 com. b, at p. 22.)

Cruttenden and Sutro contend, however, that none of the statements alleged to have been made by Carty were false. Carty was alleged to have represented that the documents were standard, a formality and did not affect the rights of the Lynches. It may be true that the documents were standard, but it is untrue that the documents were a formality and that they did not affect the Lynches' rights.

If the agreements are enforceable, the Lynches have waived their right to a jury trial, limited their discovery rights, and waived their right to appeal. It is anomalous for Cruttenden and Sutro to argue [*6] on appeal they are trying to enforce an agreement against the Lynches, and to also argue the agreement is a formality and does not affect the Lynches' rights.

Cruttenden and Sutro claim the Lynches cannot rely on their own failure to read the agreements. However, California cases have consistently taken the position that where a plaintiff is unfamiliar with the nature of the documents used in the stock-brokerage business and is deceived as to the nature and effect of the documents, failure to read the documents is excusable. (See *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1977) 67 Cal. App. 3d 19, 30-33, 136 Cal. Rptr. 378; Strotz v. Dean Witter Reynolds, Inc., supra, 223 Cal. App. 3d 208, 218-219; Rice v. Dean Witter Reynolds, Inc. (1991) 235 Cal. App. 3d 1016, 1025-1026.)* The general rule in California is that even in the absence

of a fiduciary relationship plaintiff's failure to read a contract is excusable where reliance is placed on the misrepresentations of the other party. (1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 407, p. 366.) The Restatement of Contracts Second adopts a similar position. (See [*7] Rest.2d Contracts, § 177.)

Our recent decision in *Rowland v. Paine Webber Inc. (1992) 4 Cal.App.4th 279* is not to the contrary. There Rowland was a former securities broker and employee of Paine Webber, and "presumably, he was familiar with all industry contract terms necessary to open an investment account." *(Id. at p. 286.)* Here the representation that the documents did not affect the Lynches' rights is equivalent to a representation that the documents are not contracts, a deception as to the nature and effect of the documents.

Cruttenden and Sutro stated at oral argument that the Lynches never alleged they did not know they were signing contracts. But the Lynches alleged they were ignorant of the falsity of Carty's representations and believed them to be true. The Lynches could not have believed Carty's representation that the documents would not affect their legal rights, and also have known they were signing contracts.

As to Carty's status as a non-lawyer, a person may be found to have reasonably relied on the legal opinion of a non-lawyer where the recipient of the opinion is in a relationship of trust and confidence, or where [*8] the recipient of the opinion reasonably believes that, as compared with himself, the maker of the opinion has special knowledge or skill with respect to the subject matter. (Rest.2d, Contracts, §§ 169, 170; and com. b to § 170 [reliance may be reasonable where, for example, a real estate broker or insurance agent gives an opinion of law on a routine matter within his competence to a layman]; 5 Witkin, Summary of Cal. Law (9th ed. 1988) Torts, §§ 680, 682, 684, pp. 781-782, 784, 785.) The Lynches' allegations are sufficient to bring them within either of these circumstances.

Cruttenden and Sutro's reliance on *Cohen v. Wedbush, Noble, Cooke, Inc. (9th Cir. 1988) 841 F.2d 282* is misplaced. There the Cohens signed a margin account agreement containing an arbitra-

tion clause. In response to Wedbush's motion to compel arbitration the Cohens alleged that Wedbush did not explain the meaning and effect of the arbitration clause. The court held: "We know of no case holding that parties dealing at arm's length have a duty to explain to each other the terms of a written contract. We decline to impose such an obligation. . . ." *(Id. at p. 287.)* [*9]

In response to the Cohens' allegation that they were advised " '. . . either expressly or implicitly . . .' " that the agreement did not compromise any of their rights, the court replied, "Even assuming the dubious proposition that an 'implicit' statement by a non-lawyer regarding a question of law can constitute fraud, the alleged statement here cannot fairly be characterized as fraud in the inducement as to the arbitration clause." *(Cohen v. Wedbush, Noble, Cooke, Inc., supra, 841 F.2d 282, 287.)*

The court also said that even assuming the alleged statements were specifically directed to the arbitration clause there was no fraud because reliance on a misrepresentation is not reasonable when plaintiff could have ascertained the truth by reading the contract. *(Cohen v. Wedbush, Noble, Cooke, Inc., supra, 841 F.2d 282, 287.)*

In Cohen the court assumed the parties were dealing at arm's length. The case did not discuss whether Wedbush was acting in a fiduciary capacity. Where a person reposes trust and confidence in another and the person in whom such confidence is reposed obtains control over the other person's affairs, a fiduciary relationship [*10] is created. *(Ford v. Shearson Lehman American Express, Inc. (1986) 180 Cal. App. 3d 1011, 1020, 225 Cal. Rptr. 895.)* Here the Lynches allege that Carty obtained control over their funds through the trust and confidence they reposed in him as a friend and a purported expert in investments. The Lynches also alleged that Carty was acting as the agent of Cruttenden and Sutro. This is sufficient to allege that the defendants were acting in a fiduciary capacity.

Second, as we will discuss below, we fail to see why a representation that signing a document will not affect the Lynches rights, cannot fairly be characterized as fraud going directly as to the arbitration clause, a clause that clearly affects the Lynches' rights.

Third, in stating there could be no fraud if the plaintiffs did not read the contract, the Cohen court ignored California authority and the Restatement, which are to the contrary.

II

Cruttenden and Sutro next contend that even if the elements of fraud are sufficiently alleged, arbitration is required under *Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 395.*

Prima Paint contracted to buy F & C's business. The parties also contracted [*11] that F & C would serve as a consultant to Prima Paint for six years. The consulting agreement contained an arbitration clause. No reference was made in the agreements to possible financial problems which F & C might encounter. Shortly after the first payment was due under the consulting agreement, Prima Paint notified F & C's attorney that their client had fraudulently represented it was solvent and able to perform its contractual obligations, whereas it was insolvent and intended to file a petition in bankruptcy. Prima Paint filed suit for recision on the ground of fraud in the inducement. F & C sought to stay the court proceeding pending arbitration.

In upholding the order staying proceedings pending arbitration, the court pointed out that there was a conflict in the federal courts of appeals over whether ". . . arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are imbedded. . . ." *(Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 395, 402.)* If separable, the arbitration clause is broad enough to encompass claims of fraud ". . . where no claim is made that fraud was directed to the arbitration clause [*12] itself. . . ." (Ibid.)

The Supreme Court held the answer was to be found in section 4 of the Federal Arbitration Act. "Under § 4, . . . the federal court is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue.' Accordingly, if the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the 'making' of the agreement to arbitrate — the federal court may proceed to adjudicate

it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *(Prima Paint Corp. v. Flood & Conklin, supra, 388 U.S. 403-404,* fns. omitted.)

Cruttenden and Sutro argue that here the claim of fraud goes to the inducement of the contract generally, and does not go to the making of the agreement for arbitration. We disagree. The alleged representation that the documents were a formality and did not affect the rights of the Lynches, was tantamount to a representation that documents contained no arbitration clause. Because the representation is in direct [*13] conflict with the existence of an arbitration clause, the making of the agreement for arbitration is in issue and the court has no power to order arbitration under section 4 of the Act.

That the misrepresentation may go to some or even all of the clauses of the contract as well as the arbitration clause does not mean that fraud in the making of agreement for arbitration is not in issue. Prima Paint does not stand for the proposition that a fraudulently induced arbitration agreement becomes valid and enforceable if the fraud also goes to other parts of the contract. Prima Paint simply interpreted section 4 of the Act as requiring the arbitration provision of the contract to be treated as a separate agreement for the purpose of determining whether it is enforceable.

The fraud alleged in Prima Paint concerned misrepresentation of a party's financial condition. In contrast to the instant case there was no allegation in Prima Paint that a party was misled as to the existence or effect of the arbitration clause. Here, it is alleged the parties were misled as to the very existence of the arbitration clause. In Prima Paint the fraud went to the making of the contract generally, not to the [*14] making of the arbitration clause.

California cases are unanimous in holding that Prima Paint does not require arbitration where, as alleged here, the plaintiffs were so deceived they did not understand they were contracting. *(Ford v. Shearson Lehman American Express, Inc., supra, 180 Cal.App.3d 1015, 1028-1029; Strotz v. Dean Witter Reynolds,*

Inc., supra, 223 Cal.App.3d 208, 217; Rice v. Dean Witter Reynolds, Inc., supra, 235 Cal.App.3d 1016, 1023; compare, *Rowland v. Paine Webber Inc., supra, 4 Cal. App. 4th 279,* where plaintiff, a retired stockholder, could not have been so deceived.) Such a fraud necessarily raises issues that go directly to the making of the agreement to arbitrate. Thus under section 4 of the Act the court may not order arbitration unless those issues are resolved in court against the plaintiffs.

Cruttenden and Sutro seek to distinguish Ford, Strotz and Rice on the ground that in those cases the defendants exerted complete dominion and control over the plaintiff's affairs. But we know of no requirement that plaintiffs allege complete dominion or control in [*15] order to sustain an allegation of fraud. We agree with the trial court judges. The allegations in the instant case are sufficient.

The orders denying the defendants' motions for arbitration are affirmed. Costs on appeal are awarded to the Lynches.

YEGAN, J., and WILLARD, J., concurring.

IN THE SUPREME COURT
OF THE
STATE OF CALIFORNIA

Second Appellate District
Division Six
No. B065198/B066610
S035471

IN BANK

ROBERT A. LYNCH Et Al.,
Respondents

v.

CRUTTENDEN & COMPANY Et Al.,
Appellants.

Appellants' petition for review DENIED.

LUCAS
Chief Justice

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JOHN R. LOFTUS (126841)
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Cruttenden & Company, Talley McNeil & Company, Inc., and Robert C. Carty, Jr.

SUPERIOR COURT OF CALIFORNIA
COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,
Plaintiffs,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,
Defendants.

No. 119524

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION TO COMPEL ARBITRATION AND STAY PROCEEDINGS; DECLARATIONS OF ROBERT C. CARTY, JR., MARILYN FRANCE, AND JOHN R. LOFTUS

Date: February 19, 1992
Time: 3:30 p.m.
Dept: 43

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Cal. Code Civ. Proc. § 1281.4 .....

III.

LEGAL ARGUMENT

A. THE FEDERAL ARBITRATION ACT REQUIRES THAT THE COURT ENFORCE THE PARTIES' AGREEMENT TO ARBITRATE CONTROVERSIES.

The issue of whether an agreement to arbitrate is valid is determined by federal law. *See Shearson/American Express, Inc. v. McMahon,* 482 U.S. 220, 96 L.Ed. 2d 185, 107 S. Ct. 2332 (1987); *see also Letizia v. Prudential-Bache Sec. Inc.,* 802 F.2d 1185, 1187 (9th Cir. 1986). Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (1982), provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." As the transactions for the plaintiffs' account involve national securities exchanges, this is a contract evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.,* 841 F.2d 282, 284 (9th Cir. 1988).

Two recent opinions of the U.S. Supreme Court have reaffirmed the strong federal policy in favor of arbitration. *Shearson/American Express, Inc. v. McMahon, supra; Rodriguez de Quijas v. Shearson/American Express Inc.,* 490 U.S. ____, 104 L.Ed. 2d 526, 109 S. Ct. 1917 (1989). The Supreme Court stated in *McMahon:*

> The Arbitration Act thus establishes a federal policy favoring arbitration, *Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.,* 460 U.S. 1, 74 L.Ed. 2d 765, 103 S. Ct. 927 (1983), requiring that we vigorously enforce agreements to arbitrate.

470 U.S. 213, 221 (1985). In an earlier decision, the Court stated:

> Section 2 is a Congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. . . . The Arbitration Act establishes that, as a matter of federal law, *any doubts concerning the scope of arbitratable issues*

> *should be resolved in favor of arbitration,* whether the problem at hand in the construction of the contract language itself or an allegation of waiver, delay or like defense to arbitrability.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., supra, 460 U.S. at 24-25).

The Ninth Circuit Court of Appeals has held that, on issues of arbitration, federal law preempts state law. *Bayma v. Smith Barney, Harris Upham & Co.,* 784 F.2d 1023, 1025 (9th Cir. 1986). California courts have also recognized that federal law preempts state law on issues of arbitrability. *Tonetti v. Shirley,* 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs,

VS.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,

Defendants.

Case No. 119524

DEFENDANT SUTRO & CO., INCORPORATED'S PETITION TO COMPEL ARBITRATION AND MOTION TO STAY FURTHER PROCEEDINGS IN THIS ACTION

Date: March 12, 1992
Time: 3:30 p.m.
Courtroom: 30

Petitioner Sutro & Co., Incorporated ("Sutro"), pursuant to Code of Civil Procedure Sections 1281.2 and 1292.4, petitions this Court for an order pursuant to Sections 3 and 4 of the Federal Arbitration Act (9 U.S.C. §§ 3,4), compelling Plaintiffs to arbitrate all claims asserted in their Complaint against Sutro, and for an order staying further proceedings in this action until such arbitration has been concluded. Sutro alleges as follows:

1. On or about February 27, 1989, Plaintiffs Robert A. Lynch and Betty Laverne Lynch, signed a written Client Agreement. A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit A which provides in paragraph 9 that:

> "... all controversies which may arise between you and us concerning any transaction or the construction, performance, or breach of this or any other agreement between you and us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration. ..."

2. On or about April 5, 1989, Plaintiffs signed a written "Client Agreement-Fee in Lieu of Commission." A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit B which provides that:

> "Client agrees that any dispute arising out of the services described in this Agreement shall be resolved by arbitration before the National Association of Securities Dealers, Inc. on the New York Stock Exchange."

3. The "Client Agreement-Fee in Lieu of Commission" was temporarily amended on December 8, 1989. A true and correct copy of the Amendment is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit C.

4. On or about July 28, 1989, Plaintiffs signed a written Option Agreement. A true and correct copy of that agreement is attached to the Declaration of Gilbert R. Serota filed herewith as Exhibit D which provides that:

> "... all controversies which may arise between us concerning any transaction or the construction, performance, or breach of this or any other agreement between us, whether entered

into prior, on, or subsequent to the date hereof, shall be determined by arbitration."

5. Based on Plaintiffs' Complaint, in or after 1989, a controversy arose between Sutro and Plaintiffs concerning Plaintiffs' securities transaction and investment relationship with Sutro.

6. The controversy, as alleged by Plaintiffs, is as follows: Defendants made certain false representations and withheld certain material facts regarding Plaintiffs' accounts and handled Plaintiffs' accounts in such a manner as to effectuate a profit for its own gain in a manner which subjected Plaintiffs to high investment risks and resulted in breaches of contract and fiduciary duty.

7. On January 31, 1992, Sutro requested Plaintiffs to arbitrate in accordance with the terms of the above-mentioned Client Agreement, Client Agreement-Fee in Lieu of Commission, and Option Agreement, but Plaintiffs have refused to do so by failing to respond to Sutro's request. Subsequently, on February 7, 1992, Sutro elected the New York Stock Exchange as the arbitral forum, as it was entitled to do pursuant to the terms of the agreement when Plaintiffs failed to respond.

8. The arbitration agreements herein alleged require that Sutro and Plaintiffs arbitrate such controversy in its entirety.

WHEREFORE, Petitioner Sutro prays:

1. That the Court order Plaintiffs to arbitrate the said dispute as alleged in the Complaint before the New York Stock Exchange;

2. For an order staying all proceedings in this action pending determination of this petition and, if granted, pending arbitration of the controversy herein alleged; and

3. For such other and further relief as the Court deems appropriate.

DATED: February 20, 1992.

GILBERT R. SEROTA
HOWARD, RICE, NEMEROVSKI,
CANADY, ROBERTSON & FALK
A Professional Corporation

By _____
GILBERT R. SEROTA
Attorneys for Defendant
Sutro & Co., Incorporated

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES OF THE ROBERT A. LYNCH AND
BETTY LAVERNE LYNCH FAMILY TRUST
DATED MAY 30, 1979,
Plaintiffs,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY,
INC., SUTRO & CO., INC., ROBERT C. CARTY, JR.,
SUN LIFE ASSURANCE COMPANY OF CANADA,
SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1
through 100, inclusive,
Defendants.

Case No. 119524

Courtroom 43

Hon. EDWIN M. OSBORNE, Judge

REPORTER'S TRANSCRIPT OF PROCEEDINGS
Wednesday, February 19, 1992

APPEARANCES:

For Plaintiffs: GOLDENRING & GOLDENRING
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For Defendants:
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RHONDA JEFFREY, CSR 5364
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Hall Of Justice, Room 313
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Journal, *Mago v. Shearson Lehman Hutton.* It is a Ninth Circuit case, but it reemphasizes again the rule in *Prima Paint.* If the fraud alleged goes to the inducement of the contract as a whole as opposed to the arbitration clause within the contract, then that is an issue which must be referred to arbitration.

Now, the way the plaintiffs have presented their argument in light of the *Strotz* case really goes against the rule in *Prima Paint.*

THE COURT: I hear what you are saying if the Ninth Circuit is interpreting — is stating correctly the rule. But when I look back at *Strotz* and *Rice*, I can't distinguish the type of allegation that was held sufficiently.

MS. SCHOCK: But I think that the *Mago* case stands for the proposition that *Strotz* interpreted, as the plaintiffs in this case interpreted, that is that they are alleging that the fraud went to their signing the nine agreements, that that interpretation of *Strotz* has been preempted by federal law and it is not valid.

Now, the only way *Strotz* and *Rice* can make sense is that if the fraud is so severe the plaintiff is so beguiled as to not understand the act of contracting itself. That is made most clear in *Rice* where Mrs. Rice was actually told that what she was signing was not a contract for arbitration services.

THE COURT: I am familiar with the facts. It may be that the Ninth circuit case which I have not read is correct, but it is not binding on this court. And *Strotz* and *Rice* I think are right or wrong. So I don't think it does me any good or anyone else any good to further analyze those.

As I say, the motion to compel arbitration and stay proceedings is denied.

MR. GOLDENRING: I will give notice, Your Honor, because there are other people who were served, but have not appeared yet.

MS SCHOCK: Thank you, Your Honor. At one point the parties were discussing limited discovery as to the arbitration question itself. Since that is the only issue that is before the court at this time, we would propose that discovery —

THE COURT: Let me address that in this way. I believe what is before the court is whatever *Strotz* and *Rice* say the issues are as far as fraud in the inception. But I am not prepared in advance to start trying to give an outline as to what does and does not fit within that. If that, as I rather suspect, becomes a matter of contention, that will require more than my sitting here and winging it for guidance.

MR. GOLDENRING: Just for the record, Your Honor, it's our view that the entire case is before the court until some bifurcated proceeding occurs.

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,
Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,
Appellants.

No. _____
Superior Court
No. 119524

APPEAL FROM THE SUPERIOR COURT
OF VENTURA COUNTY
HONORABLE STEVEN Z. PERREN
JUDGE PRESIDING
REPORTER'S TRANSCRIPT ON APPEAL

APPEARANCES:

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For the Appellants:
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SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF VENTURA

HON. STEVEN Z. PERREN, JUDGE

ROBERT A. LYNCH, et. al.,
Plaintiffs,
vs.
Cruttenden & Company, et. al.,
Defendants.

COURTROOM 22
No. 119524

REPORTER'S TRANSCRIPT ON APPEAL
Thursday, March 12, 1992

APPEARANCES:

For the Plaintiffs: PETER GOLDENRING
Attorney at Law

For the Defendants: GILBERT SEROTA
Attorney at Law

Reported by: SHARON LINDLEY LEWIS, CSR 6822
Official Reporter
800 South Victoria Avenue
Room 313
Ventura, California 93009

VENTURA, CALIFORNIA
THURSDAY, MARCH 12, 1993
AFTERNOON SESSION

THE COURT: Lynch vs. Cruttenden, et al. Tentative is to deny the motion to compel arbitration and to do so based upon a statement that could not have been made better than, "Gee, if all it takes is an allegation of this nature, then everybody can avoid arbitration," and the answer is you're absolutely right.

MR. SEROTA: May I address that, your Honor?

THE COURT: You may.

MR. SEROTA: I'm Gil Serota, representing Sutro & Company, the moving party.

Your Honor, we move to compel arbitration on the basis of three contracts and a fourth written document which amends one of the prior contracts, and I put those in evidence through my declaration, my authentication of that which is consistent with Evidence Code 400. There's been no denial by the Lynchs that they signed all those contracts.

THE COURT: Then you want a motion for summary judgment on the issue, essentially, don't you?

MR. SEROTA: Pardon me?

THE COURT: Isn't this then a motion for summary judgment?

MR. SEROTA: On arbitration?

THE COURT: Uh-huh.

MR. SEROTA: Typically, your Honor, under the Federal Arbitration Act as well as California Code of Arbitration Procedures these things are handled as law and motion matters with a petition to compel, which is what we filed, accompanied by a noticed motion for hearing.

THE COURT: Okay. As I understand it, then, if I deny your motion then the trial is had, almost a bifurcated trial issue. The fact that I deny your motion doesn't necessarily mean that the entirety of the contract becomes a matter of the state court, but

rather the first issue tried for whatever trial judge managing it would be the issue of fraud in the inception or however it's characterized. I think that's the most recent phrase that's used.

You try that issue, and it seems to me that issue can be framed on motion for summary adjudication or summary judgment, if it's based upon your declarations and there's a factual issue, if there's fraud in the inducement, I have by declarations under penalty of perjury an allegation by both of the plaintiffs to the effect that were induced into this.

Hey, somebody got it right. There's no sense in avoiding that. And once you get to that point there has to be a factual adjudication of the issue. They swear under penalty of perjury they were led down the primrose path and induced to sign something they didn't know to be a contract.

You know, if I'm sitting here looking at this, I'm a bit cynical that a man who runs a cement business and has a 5 million dollar business was led down the primrose path. I think it's a hoak. But, you kow what, I can't make that finding on this record and I don't think I'm permitted to. He makes a declaration that put it in the declaration of the State Court. It may be true, but that's a decision of fact and that's beyond the declarations that I have before me.

MR. SEROTA: If I could, that's exactly the point I'd like to address for just a moment, if I could.

THE COURT: Go ahead.

MR. SEROTA: I think the Court — First of all, you correctly identified the procedural context that we're in and what will happen, as I understand it, if the motion is denied and there's no appeal that overrules it.

The question before the Court, as I understand it, then, is are these declarations sufficient under Federal law and under the California State Court law, which is interpreting Federal law, to avoid arbitration at this stage and that's the point I want to address, because I don't think they are.

THE COURT: Go ahead.

MR. SEROTA: We all agree the Federal law controls I think and we certainly agree Strotz and Rice says that and we all also agree that Federal law compels a presumption in favor of arbitration, and if there are any doubts that those are in favor of arbitration.

The question then becomes, if you have contracts in front of you what do they have to allege to get back into court for at least the determination of fraud in the inception? There's two things — there's two things that I think get you into court, and I don't think they've alleged either one in any reasonable or particular way. Number one is if you read Prima Paint and read Strotz —

THE COURT: Didn't read Prima but studied Strotz.

MR. SEROTA: Strotz says that an allegation of a fraudulent scheme in general is not enough.

THE COURT: True.

MR. SEROTA: You have to allege fraud in the agreement to arbitrate itself. That's one way.

THE COURT: Not exactly.

MR. SEROTA: Well —

THE COURT: If I —

MR. SEROTA: At Strotz in the Cal.App.3d that I have, Page 214 it says,

> "The issue of fraud is to be decided by the Court only where it is alleged the arbitration agreement itself was obtained by fraud or is part of a fraudulent scheme. It is not sufficient to allege simply that the arbitration agreement is located in a contract which was otherwise procured by fraud."

And that's in the middle of middle paragraph, Page 214. Here there is —

THE COURT: I'm looking at Page 214. Are you talking about the paragraph with the word, "thus"?

MR. SEROTA: Yes. And if you look at the second sentence it begins with the issue of fraud.

THE COURT: But you have to read that. You're not reading the whole paragraph. You're construing Prima Paint but the key language is 218, Head Note 3, that's the key line.

MR. SEROTA: Well, I want to address the Court's attention to the analysis that gets you there, because I agree the head note says, "Allegations of fraud in the inception."

THE COURT: I didn't read just the head note, I read the text. Judge is supposed to do more.

MR. SEROTA: I agree with it. What we're talking about at this point in time is what the allegation of fraud in the inception that gets you this far.

THE COURT: Here the allegation made by the Lynchs under their declaration is Mr. Carty wormed his way into their confidence; having done so, put himself in a position having known they were about to retire, when in a moment of weakness the plaintiff said, "You know, I've been thinking of what to do with my five million."

Mr. Carty, well schooled in the oily practice of the securities exchange says, "I have a plan for you. Here, let me have your money and I'll take care of it. Just sign these meaningless documents." That's Mr. — plaintiff's allegations.

MR. SEROTA: In fact, what they say is the documents were standard and a formality. That's what's — I want the Court to focus on that for a second.

THE COURT: Go ahead.

MR. SEROTA: The first way I see these cases saying you get out of arbitration if you were induced to enter arbitration agreement by fraud. That's where somebody says there's no arbitration agreement in here. Don't worry. Sign it. That's not this case.

THE COURT: Correct.

MR. SEROTA: Okay. Question then is fraud in the inception, and what does that mean, and therefore what do you have to allege?

THE COURT: Uh-huh.

MR. SEROTA: In all these cases, Lynch, Strotz and Ford, what it means is that the person did not know that he was even entering a contract that's —

THE COURT: That's basically true.

MR. SEROTA: Okay.

THE COURT: Or if he knew he was entering a contract, it wasn't a contract for anything he knew about it.

MR. SEROTA: In Rice they describe Ford and they say the promisore is deceived as to the nature of his act.

THE COURT: Right.

MR. SEROTA: Does not know what he was signing, did not intend to enter into a contract.

THE COURT: Right.

MR. SEROTA: Okay. Now, I do not believe that in these declarations of the Lynchs you will see anything that says that when they signed the contracts with Sutro on four different dates, on four different occasions they didn't know that they were entering into a contract. Because they say they were told it was a formality, they were told it was standard, but they don't say that we didn't believe that there was a contract, and even if they did it would be rebutted by the letter that we produced as Exhibit 3 or Exhibit C to my declaration, because in Exhibit C —

THE COURT: Just a second. Bear with me. Here we are. Yes.

MR. SEROTA: Exhibit C is a letter.

THE COURT: Uh-huh.

MR. SEROTA: Doesn't contain any hidden anything. It says to temporarily amend our client agreement.

THE COURT: Uh-huh.

MR. SEROTA: Now, how is it that someone could sign something that amends something else whose only purpose is to amend something else and claim that they didn't know they were entering into a contract or had entered into a contract.

THE COURT: And the answer is I haven't a clue. That's what the contract trial is going to be about.

MR. SEROTA: But they haven't alleged — my point is, your Honor, that they have not alleged in their papers that they were deceived as to the nature of this document. They don't even address this document in their papers. They don't even explain it. They don't even make the initial showing that would get them out of arbitration.

To get them out of arbitration they would have to say and explain in some kind of particularized way how they could sign four separate dates, four separate documents and not know they're entering into a contract. That's not in their declaration, and that's why I don't think they've made the showing that is required under a fair reading of Strotz and Rice when put into context with Federal law.

Because fraud in the inception just doesn't mean that I say this whole thing was part of a general fraudulent scheme. You've got to say that I either — the specific agreement to arbitrate was fraudulently induced, which they don't or I didn't know I was signing any contract at all, which they don't.

Now, these things may well have been formalities, they may well have been standard, but that doesn't mean they didn't know they were signing a contract.

And if a declarant doesn't explain in his opposition to the motion, how this letter could have come about amending a contract, he doesn't meet the burden to get over the presumption of arbitration, and that's why I think it would be wrong to read Strotz and Rice so broadly that all they have to do is allege, as you said, a broad scheme of trust and reliance and I was told it was a formality because that's not enough.

That puts you in Prima Paint. That puts you in what Strotz said is if it's a general fraudulent scheme it's for the arbitrator. If it's

specific to the arbitration agreement that's for the judge, and then there's this fraud in the inception which is like Mrs. Rice. Mrs. Rice thought she was making a loan. I mean there's no allegation of that here. They knew they were investing their money with Sutro. They hoped they weren't signing their life away, but nobody says they were signing their life away. Okay.

In Ford, the other case they rely on, the poor man had given blank checks and credit cards and bill paying authority and all the rest to the guy who induced him to enter into this agreement. That's not this case.

And so my point is that to avoid the exception undermining the rule, you've got to take an approach that says do they really meet this standard, do they really prove or allege in their declarations fraud in the inception. And I don't think there's anything in their declarations that say I didn't know I was contracting. I didn't know I was entering into a formal relationship. They say standard and formal. Again, I don't think that's enough.

That's really our point on this, and I would just urge the Court, and maybe you don't have copies — I can hand them up. Cohen vs. Wedbush, Noble and Cooke, Ninth Circuit case said it's not enough to allege, for example, that the arbitration agreement was undisclosed or that it was adhesive or unconscionable. That doesn't get you a separate trial on fraud and Hurlbut case from the District of Massachusetts is the same thing.

It's not enough to say I wasn't allowed to read it, wasn't given legal advice, it wasn't explained to me. That doesn't get you in fraud in the inception or to a separate trial on the issue of arbitration, and that's where I think the failing is in this case and in the generalized declarations.

And I would be happy to hand those federal cases up to the Court if you'd like to look at them.

MR. GOLDENRING: If I might respond, your Honor.

THE COURT: You may.

MR. GOLDENRING: What counsel is attempting to do is make this the summary judgment motion or bifurcated trial.

A reading of Strotz and Rice made clear that all that is at issue now is whether there is an allegation and if there is an allegation then the petition is denied. At that point, at the defendant's election they can seek the bifurcated trial or not if they choose. That's then their choice.

The argument of counsel is essentially identical to that which was placed before Judge Osborne by Talley McNeil and Cruttenden. The Sutro documents were before Judge Osborne in the petition.

If you look at the original basically Mr. Carty was Sutro, started the relationship, moved over to Talley McNeil, which became Cruttenden, and took the Lynchs along with him, and all of the documents were before Judge Osborne in the Talley McNeil, Cruttenden petition and the identical argument was made.

What the argument really is when you cut through the niceties of language of counsel is that if there's an understanding that there's a business relationship then *ipso facto* arbitration follows. Unless someone can claim that they don't have any basis to understand that there's a business relationship, then they are required to proceed to arbitration.

In Strotz the language is very clear of the Court each time. According to plaintiff, defendants advised her that these, the documents being presented were simply standard forms required for her act and there was nothing to worry about. She also stated in her declaration that she signed these — this document in reliance on defendant's assurances that these documents were merely standard forms.

In Rice, again, she's presented standard forms and both context. There's no allegation by the plaintiff that they didn't know that there was a business relationship occurring.

To interpret Strotz and Rice in that fashion is to essentially gut them. What both of those cases talk about is that in the context of the fiduciary relationship is there the allegation that meets either the inception or permeation theory, and I don't want to lose sight of the fact that both theories exist in California law and they have

not been reconciled as specifically articulated in the Rice case that they rule only on inception.

THE COURT: Permeation seems to be in its death row in all candor.

MR. GOLDENRING: I'm not disagreeing, but specifically the Rice court, the latest articulation makes clear it is not ruling on the permeation doctrine and simply on the inception.

What is critical it seems to me, your Honor, is the language of the Court in its holding in Strotz because there's no ambiguity in that holding and counsel's articulations to the contrary.

It is not Federal law by which what we measure the allegation — by which we measure the allegation. The fact that a Federal court back east or Ninth Circuit is talking about what they think the Federal Arbitration Act means is irrelevant, because none of those cases talk about California law which is the measure under Strotz and Rice.

In Strotz the Court says, without any limitations as to the nature of the relationship it says:

> "Accordingly, we hold absolutely, we hold that allegations of fraud in the inception or execution of a contract which contains an agreement to arbitrate are sufficient to place the issue of fraud before the Court and deny a petition to compel arbitration."

Here the plaintiff has alleged that the —

THE COURT: I've got that.

MR. GOLDENRING: That's where we're at, and as much as defendants want — and I mean it's the argument that I heard in front of Judge Osborne. As much as they want to try to narrow those cases, the holdings of those cases are not narrow at all.

Once the allegation is made then the matter is a triable issue of fact in the context of the fiduciary relationship that exists and that's a determination that occurs in the bifurcated trial if that's what the defendants choose to proceed with. That's their option once the Court denies the motion, if the Court so chooses.

There is no language that narrows either Strotz or Rice in their holdings to the blind, deaf, dumb person who doesn't even know that they're signing a document. That's not what those cases hold and that's not what the facts are. In both cases they were standard documents and both cases they were told, don't read them, don't worry, they're just standard formalities for us to take care of you.

And what has occurred in this case is my clients were presented with various documents at various points in time in the context of this, and that's what occurred, and our allegations, your Honor, are sufficient indeed under Strotz.

It is probably true that the allegations in the Complaint alone are sufficient if the Complaint had been verified, because the Court talks in Strotz about allegations in the complaint as well as by declaration, but I present both so that this Court has a feeling not just from the pleading what its nature is but also as to the nature of its relationship so the Court has some depth in terms of it, but the measure of the depth, or the truthfulness of the declarations or the believability of my clients or the weighing of that evidence is not what occurs today.

Once the allegations are married that's enough for us to go to the next step, which is the trial on the bifurcated proceeding where a trier of fact makes those determinations.

MR. SEROTA: Your Honor, four brief points to make in rebuttal.

First of all, let me address Strotz. We, all three of us read the words that have been quoted by you, by Mr. Goldenring and myself, but that's conclusion allegations of fraud in the inception. The question is are there allegations of fraud in the inception that are sufficient to get past this motion.

In Strotz at the bottom of 317 is where they define what is fraud in the inception, which is we agree that if a party is unaware he is signing any contract, obviously he also is unaware he is agreeing to arbitration. I think that's the definition of fraud in the inception and I certainly —

Strotz was clarified by the Court in Rice which clearly stated that fraud in the inception is someone who is deceived as to the

nature of her act and actually did not know what she was signing. Again, there a loan agreement masquerading as a contract. That's point one.

THE COURT: Other way around I think.

MR. SEROTA: They were — she thought it was a loan agreement. Okay.

Point two is: The statement that you should ignore Federal cases in making this determination. Okay. I think that's clearly wrong.

And in Moses Cone vs. Mercury Construction, United States Supreme Court, addressing Section 2 of the Federal Arbitration Act, which is what we've invoked here, says that Section 2 is a congressional declaration of a liberal Federal policy favoring arbitration agreements notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of Federal substantive law applicable to any arbitration agreement within the coverage of the act. That doesn't allow counsel's argument that you can ignore Federal law.

The final point is, if you follow Federal law and you look at the Ninth Circuit case in Cohen vs. Wedbush, Noble and Cooke, there the Cohens say they were never advised that the margin agreement compromised any of their rights. That's the allegation. The Ninth Circuit says:

> "Even assuming the dubious proposition that an implicit statement regarding a question of law can be fraud, this is not fraud in the inducement of the arbitration agreement, and this allegation goes to arbitration."

So where I come out again on this is in the — taking their declarations at face value, as I think you need to, there is not an allegation that they were fraudulently induced to enter the arbitration agreement itself. No one lied about its existence or nonexistence or anything.

THE COURT: I think that's where we part. That's exactly what can be gleaned from this starting at Page 7, Line 2 and running through Page 8, Line 12.

MR. SEROTA: They said they didn't know.

THE COURT: They start off by saying, "We were told ignore these documents. They're mere formalities. Just give us the signature. Don't worry about them." They worry on the fiduciary, whom they place trust and hope, and unbeknownst to them contained in the documents that they were told expressly to ignore was language, which had they known it was there they would have never signed and specifically intended not to waive.

I think it gets it.

MR. SEROTA: Cohen vs. Wedbush, Noble and Cooke says no way on that, exactly on that. It says that requiring reasonable investigation by the parties claiming fraud is appropriate in cases where the explicit language of the contract directly contradicts the alleged misrepresentation.

We see no unfairness in expecting parties to read contracts before they sign them, and that this reasoning is particularly pervasive in the context of arbitration clauses where permitting plaintiffs to present their claims to a jury would frustrate the very policies these clauses and the arbitration act itself are meant to promote, the very thing we were induced not to read this. We were told that this didn't compromise our rights is absolutely rejected by the Ninth Circuit and they're sent to arbitration. That's Federal law.

And quite frankly I still don't think that's inconsistent with Strotz and Rice, because I don't think that that's fraud in the inception. I don't think your failure to read or even being induced not to read an entire agreement is fraud in the inception.

Fraud in the inception is don't worry, it's not a contract. Don't worry, it's only a loan agreement or it's a receipt, you know, this is your receipt. They don't say that. And I know perhaps I'm hitting myself — my head against a brick wall at this point but I think —

THE COURT: I've been called other things in my time.

MR. SEROTA: But the ruling itself being a brick wall. But I think that read in the context of what Strotz and Rice stand for in

terms of fraud in the inceptions, these declarations don't make it and obviously they can't make it or they would have made it.

In other words, if they were told, you're not signing a contract, this doesn't have to do with a relationship between us, it's a receipt or it's something else, they would have said that in the declarations, they don't.

And I would just respectfully ask your Honor to take one more look at this perhaps before making a final decision. Thank you.

THE COURT: Actually I spent about, cumulative time about two hours on this file.

MR. SEROTA: I didn't mean to imply that you had not.

THE COURT: I didn't understand that to mean that. And I did it because I as utterly ignorant of the subject area.

But the only thought that comes to my mind you have my sympathy but not my ruling. I think that what Strotz has done is to eviserate the rule. I think it's a terrible case. I think it's a bad law and counter to public policy and I think it tries to abrogate the Federal rule. I can give you a list of reasons.

I think it is the, for whatever reason, a means by which the state courts have tried to usurp Federal prerogative. And there's some good reasons for that. I think they were principally brought about if I — I think it was the paint case, because under these agreements not only did they go this far but moved people in different jurisdictions where they couldn't protect themselves, and that's probably where this thing found its genesis and at its inception had pretty good reason. This is all by way of dicta at best, but I read it and was surprised at the language.

It does do exactly what you said it can do, but I think you're absolutely correct. I think that's exactly what the plaintiffs can do. I think they're going to be hard pressed to prevail. Mr. Goldenring's protestations to the contrary notwithstanding I think he's got a tough road to hoe in this case. But if he wants to lengthen it out and pick up that hoe, I guess that's his right.

Motion is denied.

MR. GOLDENRING: Your Honor, I'll give notice. There are other parties.

THE COURT: Please. This one will go up on appeal with its companion.

MR. SEROTA: We haven't made that determination.

THE COURT: I thought I saw a Notice of appeal.

MR. SEROTA: Cruttenden has appealed and we have not decided that.

MR. GOLDENRING: Also a third defendant not subject to the arbitration clause, the insurance company who's answered. So it's going to be an interesting case procedurally.

I'll give because of all the different players.

THE COURT: Thank you.

(Proceedings concluded for the day.)

REPORTER'S CERTIFICATE

STATE OF CALIFORNIA
COUNTY OF VENTURA } ss.:

I, SHARON LINDLEY LEWIS, CSR No. 6822, Certified Shorthand Reporter of the State of California, for the County of Ventura, do hereby certify that the foregoing, pages 1 through 18, comprise a full, true and correct transcript of the proceedings had in the above-entitled action on February 12, 1992.

Dated at Ventura, California, this 12th day of August, 1992.

SHARON LINDLEY LEWIS, CSR 6822
Official Reporter

2d Civ. No. B065198

COURT OF APPEAL, STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION SIX

ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually and as TRUSTEES OF THE ROBERT A. LYNCH AND BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs and Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR., SUN LIFE ASSURANCE COMPANY OF CANADA, SUN FINANCIAL GROUP, LOOMIS SAYLES & CO., DOES 1 through 100, inclusive,

Defendants and Appellants.

Ventura County Superior Court
Case No. 119524

(Hon. Edwin M. Osborne)

(Notice of Appeal Filed February 27, 1992)

APPELLANTS' OPENING BRIEF

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VII.
LEGAL ARGUMENT

A. THE FEDERAL ARBITRATION ACT REQUIRES THAT THE COURT ENFORCE THE PARTIES' AGREEMENTS TO ARBITRATE CONTROVERSIES.

It is beyond dispute that the present controversy is governed by the Federal Arbitration Act ("FAA"). 9 USC § 1 *et seq. See, Rowland v. Painewebber*, 92 Daily Journal D.A.R. 3353 (1992), *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 96 L.Ed. 2d 185, 107 S. Ct. 2332 (1987). Section 2 of the FAA provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 USC § 2 (1982). As the transactions in the Lynches' accounts involve national securities exchanges, this is a contract evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 284 (9th Cir. 1988).

The enactment of the FAA and the cases interpreting it emphasize the strong national policy in favor of arbitration. *Shearson/American Express, Inc. v. McMahon, supra; Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 104 L.Ed. 2d 526, 109 S. Ct. 1917 (1989). That policy is so strong that:

> *any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration*, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay or like defense to arbitrability.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983).

Both state and federal courts have recognized that on issues of arbitration, federal law preempts state law. *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

B. THE LYNCHES' FACTUAL ALLEGATIONS ARE INSUFFICIENT TO VITIATE THE AGREEMENTS TO ARBITRATE.

1. *The Lynches Make No Allegation That Any Statement Related to Signing the Agreements Was False.*

Since the trial court denied Cruttenden's motion to compel arbitration, this court has rendered a decision which, Cruttenden submits, is dispositive of the primary issues in this appeal.

2d Civil No. B066610

COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT (DIVISION SIX)

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES of the
ROBERT A. LYNCH AND BETTY LAVERNE LYNCH
FAMILY TRUST DATED MAY 22, 1979
Plaintiffs and Respondents,

v.

SUTRO & CO., INC.
Appellant and Defendant.

Ventura County Superior Court
Case No. 119524
(Hon. Steven Z. Perren)
(Notice of Appeal Filed April 20, 1992)

APPELLANT'S OPENING BRIEF

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Code Civ. Proc.

§ 1281.2 .....

§ 1294(a) .....

the trial court below:

> "The Court: I think that what *Strotz* has done is to eviscerate the rule. I think it's a terrible case. I think it's bad law and counter to public policy and I think it tries to abrogate the Federal rule. I can give you a list of reasons.
>
> I think it is the [sic], for whatever reason, a means by which the state courts have tried to usurp federal prerogative." (RT 17)

ARGUMENT

I.

FEDERAL LAW REQUIRES THAT ALL OF PLAINTIFFS' CLAIMS BE ARBITRATED.

A. *All of Plaintiffs' Claims Are Governed By The Federal Arbitration Act Which Required The Court To Enforce The Agreements.*

Although both the trial court and Plaintiffs' counsel treated federal arbitration law as almost an afterthought for the purposes of Sutro's motion, it is clear that the Federal Arbitration Act ("the Act") governs the present controversy and agreements to arbitrate. In enacting the Act, Congress sought to establish a federal policy in favor of the validity and enforceability of arbitration agreements which involve some aspect of commerce — such as Plaintiffs' agreements regarding securities investment. This is made clear by the language of the Act itself. Section 2 provides that:

> "A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be *valid, irrevocable, and enforceable,* save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C. § 2(emphasis added))

Thus, an agreement to arbitrate contained in a contract which pertains to any transaction involving commerce is governed by the

Act. For these purposes, the Act preempts state law on questions of enforceability, application of the agreement, and arbitrability. *See Perry v. Thomas*, 482 U.S. 483, 489 (1987) ("Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable . . . ."); *Southland Corp. v. Keating*, 465 1, 11 (1984) ("We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under the state law."); *Van Luven v. Rooney Pace, Inc.*, 195 Cal. App. 3d 1201, 1206 (1987) ("The act . . . preempts California law governing the validity of an arbitration clause.") *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1147 (1985) ("Recent United States Supreme Court cases have made it clear this federal statute preempts state law on the issue of arbitrability of an agreement falling under the Act."). This preemption, and the federal policies favoring the validity of arbitration agreements embodied in the Act, will operate despite a party's attempt to invoke state policies or laws to the contrary:

> "Section 2 is a congressional declaration of a liberal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act. . . . The Arbitration Act establishes that, *as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . .*" (*Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983) (emphasis added)).

It is this federal policy and body of substantive law of arbitrability which requires that both federal *and* state courts vigorously enforce agreements to arbitrate which fall under the Act. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (the Act requires rigorous enforcement of agreements to arbitrate); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985) (uncertainties must be resolved in favor of arbitration); *see also Rodriguez de Ouijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 478-83 (1989) (describing the

federal policy favoring arbitration embodied in the Act); *Rowland v. Paine Webber Inc.*, 4 Cal. App. 4th 279, 284 (1992) (same). There is no dispute that the arbitration agreements between Sutro and Plaintiffs were governed by the Act and federal law. Contracts which involve the national securities exchange are considered to be contracts involving "commerce" within the meaning of Section 2. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988). Moreover, arbitration agreements between brokerage firms and customers have been consistently enforced under of the Act. *E.g., Byrd*, 470 U.S. at 217.

Given this backdrop of federal policies favoring arbitration and requiring that uncertainties regarding agreements which fall within the scope of the Act be resolved in favor of enforcement, it is difficult to understand the trial court's readiness to deny Sutro's motion to compel arbitration based on exceptions which the court itself admitted were attempts to usurp federal law. This decision becomes all the more surprising once the broad scope of the agreements are examined.

Sup. Ct. No. _____
2d Civ. Nos. B065198, B066610
Ventura Sup. Ct. No. 119524

IN THE
SUPREME COURT OF CALIFORNIA

ROBERT A. LYNCH, BETTY LAVERNE LYNCH,
individually and as TRUSTEES OF THE
ROBERT A. LYNCH AND BETTY LAVERNE LYNCH
FAMILY TRUST DATED MAY 30, 1979,

Plaintiffs and Respondents,

vs.

CRUTTENDEN & COMPANY, TALLEY MCNEIL &
COMPANY, INC., SUTRO & CO., INC., ROBERT C. CARTY, JR.,
SUN LIFE ASSURANCE COMPANY OF CANADA,
SUN FINANCIAL GROUP, LOOMIS SAYLES & CO.,
DOES 1 through 100, inclusive,

Defendants and Petitioners.

After Decision by the Court of Appeal,
Second Appellate District, Division Six

PETITION FOR REVIEW

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IV.

THIS COURT SHOULD GRANT REVIEW BECAUSE THE LOWER COURT'S INTERPRETATION OF THE "PRIMA PAINT" DOCTRINE, AS IT APPLIES TO SECURITIES ARBITRATION AGREEMENTS, IS IN DIRECT CONFLICT WITH CONTROLLING FEDERAL LAW

A. FEDERAL LAW PREEMPTS CONFLICTING STATE LAW IN THE PRESENT CASE.

It is beyond dispute that the present controversy is governed by the FAA, 9 U.S.C. § 1, *et seq. See Rowland v. PaineWebber Inc.*, 4 Cal. App. 4th 279, 6 Cal. Rptr. 2d 20 (1992); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987). Section 2 of the FAA provides that a contract involving interstate commerce and containing an arbitration clause shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (1982); *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 475 (9th Cir.), *cert. denied*, 117 L. Ed. 2d 516 (1991). As the transactions in the Lynches' accounts involved national securities exchanges, these are contracts evidencing a transaction involving commerce. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 284 (9th Cir. 1988); *Macchiavelli v. Shearson Hammill*, 384 F. Supp. 21, 30 (E.D. Cal. 1974).

Both state and federal courts recognize that on issues of arbitration, federal law preempts conflicting state law. *Southland Corp. v. Keating*, 465 U.S. 1, 13, 104 S. Ct. 852, 79 L. Ed. 2d 1, 13 (1984); *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1025 (9th Cir. 1986); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148-50, 219 Cal. Rptr. 616, 618-20 (1985).

As the United States Supreme Court has decreed, the pronouncement of a federal court supersedes any contrary state law:

> But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted *to the extent that it actually conflicts with federal law* — that is, to the extent that it "stands as an obstacle to the

> accomplishments and execution of the full purposes and objectives of Congress."

Volt Info. Sys. Inc. v. Board of Trustees of the Leland Stanford Junior Univ., 489 U.S. 468, 477, 103 L. Ed. 2d 488, 499 (1989) (emphasis added).

Since the court below relied primarily upon Section 2 of the FAA to argue that state law must be applied to the exclusion of federal law in this case, it is important to review judicial interpretations of that section:

> Section 2 [of the FAA] is a Congressional declaration of a liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to the contrary*. The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.... [T]he Courts of Appeals have ... consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration, *whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability*.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25, 103 S. Ct. 927, 941, 74 L. Ed. 2d 765, 785 (1983) (emphasis added).

Thus, while it is evident that the FAA does not completely occupy the field as to arbitrability, it is clear that where the federal courts have spoken, that law controls both in state and federal courts. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984) (California Supreme Court overruled); *Perry v. Thomas*, 482 U.S. 483, 489, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (California statute preempted).

B. UNDER FEDERAL LAW, GENERALIZED CHALLENGES TO CONTRACTS CONTAINING ARBITRATION CLAUSES MUST BE COMPELLED TO ARBITRATION.

The United States Supreme Court provided the rule which governs this issue in *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967). In that case, the Court considered whether the issue of the enforceability of a contract alleged to have been fraudulently induced and which contained an arbitration provision was to be considered by a court or by arbitrators. The Court ruled that the matter was to be sent to arbitration. In so holding, the Court recognized that the arbitration clause is severable from the rest of the contract. The Court held in that regard:

> [I]f the claim is fraud in the inducement of the arbitration clause itself — an issue which goes to the "making" of the agreement to arbitrate — the federal court may proceed to adjudicate it. *But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.*

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1993

CRUTTENDEN & COMPANY, TALLEY MCNEIL & COMPANY, INC.
SUTRO & CO., INC., ROBERT C. CARTY, JR.,
SUN LIFE ASSURANCE COMPANY OF CANADA,
SUN FINANCIAL GROUP, LOOMIS & SAYLES & CO.,
DOES 1 THROUGH 100, INCLUSIVE,
Petitioners,
VS.
ROBERT A. LYNCH, BETTY LAVERNE LYNCH, individually
and TRUSTEES OF THE ROBERT A. LYNCH AND
BETTY LAVERNE LYNCH FAMILY TRUST DATED MAY 30, 1979
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF IN OPPOSITION TO WRIT OF CERTIORARI

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BRIEF IN OPPOSITION TO WRIT OF CERTIORARI

The Petition for Writ of Certiorari presented by CRUTTENDEN & COMPANY, TALLEY McNEIL & COMPANY, INC., SUTRO & CO., INC. and ROBERT C. CARTY, JR. should be denied.

STATEMENT OF THE CASE

I.

FACTS

The Petition for Writ of Certiorari correctly presents to this Court the Orders of the Superior Court of the State of California for the County of Ventura (Petition Appendix 1A-4A), the Decision of the Second District Court of Appeal for the State of California officially reported at 18 Cal.App.4th 804 (1993) (Petition Appendix 5A) and the Order of the California Supreme Court unanimously denying the Petition for Hearing, the Honorable Malcom Lucas, Chief Justice speaking for the Court (Petition Appendix 14A).

The Facts as presented by Petitioners herein are inaccurate. The accurate *evidentiary* facts are as follows:

Respondent ROBERT A. LYNCH (hereinafter referred to as ROBERT), born November 26, 1929 (Appendix 1A)[1] attended school only to the ninth grade, never graduating high school, never attending college, and never obtaining any degrees or special training from any institutions of higher learning (Appendix 1A). His wife, Respondent BETTY LAVERNE LYNCH (hereinafter referred to as **BETTY**), born May 9, 1930 (132), graduated high school in 1948 and never attended any college. After high school she briefly attended a trade school to learn shorthand and typing (Appendix 8A).

Neither **ROBERT** nor **BETTY**, prior to the events which give rise to the instant litigation had ever had a securities account at any brokerage house or any other institution. (Appendix 1A). Indeed, neither **ROBERT** or **BETTY**, prior to meeting MR. CARTY, ever had executed any stock

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[1]In the Appendix attached hereto, Respondents present to this Court the evidentiary record supporting the factual statement herein.

broker agreements, brokerage house agreements, or any other agreements of the type alleged to exist by the Appellants in the instant matter. (Appendix 1A).

ROBERT first met Defendant/Appellant MR. CARTY in 1988 while purchasing a used car from MR. CARTY'S brother in Santa Barbara. (Appendix 1A) MR. CARTY struck up **ROBERT'S** friendship. MR. CARTY told **ROBERT** he was related to many well-established multi-generational Ventura County families with whose names **ROBERT** was familiar. MR. CARTY explained that his grandfather was a close associate and personal friend of Martin Smith, the well-known Oxnard developer. MR. CARTY also told **ROBERT** that he was married to the daughter of Mr. Ted Engs of Engs-Peterbilt — another well-established Ventura and Los Angeles County family.[2] [Appendix 2A]. As the close and personal relationship between **ROBERT** and Mr. CARTY developed and grew, MR. CARTY did not initially discuss anything having to do with managing or investing the funds or properties of **ROBERT** and **BETTY.** Instead, he concentrated on be coming a close personal friend of **ROBERT.** (126) MR. CARTY would come by **ROBERT'S** office or house as often as two (2) times per week, take **ROBERT** to lunch regularly at the Tower Club at the top of the Union Bank Building in Oxnard, where they would sit at what MR. CARTY described as "Mr. Smith's private table". (Appendix 2A).

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[2]The nature of the development of the relationship between **ROBERT** and MR. CARTY is significant because unlike any of the cases presented by Petitioners, the instant matter is *not* a circumstance where Respondents went to a securities brokerage house to seek their assistance, advisement or services. In the instant matter, as set forth in the Declaration of Robert A. Lynch (commencing Appendix: 2A), **ROBERT** and **BETTY** were approached by MR. CARTY after first establishing a close and intimate personal relationship.

In the course of the many personal and intimate conversations between MR. CARTY and **ROBERT, ROBERT** told MR. CARTY that he had no experience in stocks, bonds, mutual funds, or any other kind of activity that MR. CARTY would from time to time describe. (Appendix 3A) **ROBERT** told MR. CARTY during these conversations that he did not understand most, if not all, of what MR. CARTY would describe as his business. MR. CARTY often stated to **ROBERT** that managing money safely was "his business" and that's what he was an "expert in". (Appendix 3A).

In the context of the close friendship that MR. CARTY nurtured and developed with **ROBERT** over several years, **ROBERT** started confiding with MR. CARTY that he was thinking of selling the cement business he had built from scratch (Appendix 3A), paying the taxes on the sale and retiring with the money that was left in safe investments for he and his wife and ultimately their children. (Appendix 3A) MR. CARTY, in the context of their close friendship, became very solicitous of **ROBERT**, increasing the friendship and trust that had already been established between them. [3] (Appendix 3A).

Finally, the business was sold, and the taxes paid. **ROBERT** told his friend, MR. CARTY, about the sale and at that time MR. CARTY asked **ROBERT**, as a friend, to become the personal manager of the funds for **ROBERT** and **BETTY**, and their family. (Appendix 3A) When MR. CARTY first broached the subject with his friend, **ROBERT**, about becoming the family's manager of the

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[3]During the several years where MR. CARTY nurtured the friendship and trust between he and **ROBERT**, at no time were there any business relationships between the two. At no time were there any securities accounts opened or investments made. In other words, the relationship was created and nurtured by MR. CARTY, on its face, to be that of true close friends with great trust in each other.

funds, MR. CARTY repeated and affirmed his friendship and trust with and from **ROBERT** and **BETTY**, and that **ROBERT** and **BETTY** should rely upon that trust and friendship, as well as MR. CARTY'S expertise and management skills. (Appendix 4A). [4]

In the context of the close and trusting friendship nurtured and developed by MR. CARTY over several years with **ROBERT**, and MR. CARTY'S suggestion to **ROBERT** that he (MR. CARTY) could and should take care of the family retirement, MR. CARTY came to **ROBERT** and **BETTY** and told them that he needed some "form" documents signed in order to open the accounts so he could handle the safe management of the funds. (Appendix 4A). At this time, MR. CARTY told **ROBERT** and **BETTY**, who he knew had never seen documents like this before and had never had any kind of securities account, that the documents were "standard" and "simply a formality"; and, that they were not necessary to read because they "simply effected an opening of the account and the transference of the funds to him". (Appendix 4A). At the time of the presentation of the documents, and in accordance with the long, continuing, trusting relationship

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[4]The Court's attention is respectfully directed to the Declaration of Robert A. Lynch (Appendix: 1A) and the Declaration of Betty Laverne Lynch (Appendix: 8A). This Statement of Facts while highlighting certain key issues cannot give the feeling for the declaration itself which makes clear that over the course of several years, and before MR. CARTY ever broached the subject of becoming the family investment counselor for **ROBERT** and **BETTY**, MR. CARTY nurtured a very close friendship and trusting relationship between he and **ROBERT**. It is this trusting friendship, nurtured by MR. CARTY, that formed the basis of **ROBERT** and **BETTY'S** willingness to accept MR. CARTY'S suggestion, as their close friend, to manage their money for retirement and for the children. It is also in this context, this close and trusting pre-existing friendship, that the comments of MR. CARTY and his instructions in regard to signing documents, must be measured.

that had been developed, MR. CARTY repeatedly stressed that he could be trusted and that his friends, **ROBERT** and **BETTY**, did not need to read the documents because they were "simply a formality". (Appendix 5A).[5]

When MR. CARTY told **ROBERT** and **BETTY** to sign the documents, MR. CARTY never advised **ROBERT** and **BETTY** that the documents constituted a "contract" addressing the rights and responsibilities of the parties (Appendix 5A). Indeed, there was a very specific conversation that **ROBERT** remembers with absolute clarity concerning certain of the documents at issue:

> "CARTY: These are documents I need for you to sign so I can manage your money for you. Don't worry about the documents, they're formalities, just go ahead and sign them.
>
> (**ROBERT/BETTY**): Okay — We trust you.
>
> **ROBERT** (jokingly): I hope I'm not signing my life away.
>
> CARTY (laughing): No — They're just a formality, they're not important." (Appendix 6A).

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[5]While previously stated, it is important to emphasize that MR. CARTY knew and had been told in the context of the close, personal relationship he had developed and nurtured with **ROBERT**, that **ROBERT** had never had any experience with any securities brokers or any securities transactions whatsoever and that he had never seen any documents such as these before. (Appendix: 4A). Each time MR. CARTY needed some documentation signed he would personally bring it to **ROBERT** and **BETTY**, reiterate the closeness of the pre-existing friendship and advise he simply needed a "signature" on a "standard" document as a "formality". (Appendix: 5A).

There was *no* evidence presented by Petitioners contradicting the facts as presented by **ROBERT** and **BETTY** in their respective declarations. Thus, it is undisputed that:

(1) MR. CARTY solicited, nurtured and developed a close, personal, intimate, and trusting relationship with **ROBERT** for several years *before* there was ever any execution of brokerage account documents;

(2) MR. CARTY was, in fact, a close and intimate confidante and personal friend who solicited and received **ROBERT** and **BETTY'S** trust and confidence long before he presented any documents for them to sign;

(3) MR. CARTY advised **ROBERT** and **BETTY** that the brokerage account documents that he asked them to sign were "not important" and were "not a contract"; and,

(4) As a result of the malfeasance of MR. CARTY and the various brokerage houses with whom he worked, the losses of **ROBERT** and **BETTY** have exceeded One and One Half Million Dollars ($1,500,000.00) (Appendix 6A), while at the same time MR. CARTY and the brokerage houses for whom he worked have earned commissions on Respondents' accounts in excess of One Million Dollars ($1,000,000.00) (Appendix 6A).

From the mid-1980's, the securities industry (brokerage houses) has, as an industry, effectively sought to foreclose access to courts and juries by no matter how egregious the conduct or great the harm. There has been a clear and unequivocal industry-wide attempt to simply preclude access to the courts by anyone with respect to any claim involving a brokerage house. These efforts have now reached the point where it is virtually impossible to have any kind of brokerage account without the documentation having buried within it, somewhere, an arbitration clause requiring all disputes, of any nature or type, to go before a securities industry panel in a binding fashion.

The most recent data that could be obtained in the context of the brokerage industry was as of January 1, 1989 which indicated that there were 3551 retail offices for brokerage firms in the United States. (Appendix 10A). Of those retail outlets, 2933 were of the top six brokerage houses: Dean Witter, Shearson-Lehman, Merrill-Lynch, A.G. Edwards, Prudential-Bache, Paine Webber, and Oppenheimer. Thus, eighty-seven and one-half percent (87½%) of the total retail brokerage houses as of January 1, 1989, were owned and operated by the largest six brokerage houses. (Appendix 11A). In regard to the number of registered representatives (stock brokers), as a statistic distinct from the number of stock brokerage offices, the statistics indicated that as of January 1, 1989 the total number of brokers in the United States was 58,383 with 46,170, or 79.08%, being in those same six brokerage houses above-referenced. (Appendix 11A). Each one of those brokerage houses, which control almost 90% of the brokerage house business in the United States inserts a mandatory binding arbitration clause almost identical to that in the instant matter. (Appendix 14A). Thus, an entire industry has joined together to attempt to preclude access to the courts for any of its customers.[6]

After learning of the malfeasance of the Defendants, **ROBERT** and **BETTY** filed their Complaint alleging nine causes of action. In that Complaint **ROBERT** and **BETTY** allege, inter alia, that MR. CARTY was their intimate friend and through that friendship they developed and reposed substantial trust and confidence in him; that MR. CARTY encouraged and solicited the trust and confidence of them and in that context, and after he had established the friendship and the close personal relationship, engaged in the activities that are the subject of the

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[6]Neither the Trial Court nor the Court of Appeal relied upon this ground to deny the Petition to Compel Arbitration.

Complaint that from time to time, and in the context of this close personal friendship and trust that pre-existed the activities which form the basis of the Complaint, MR. CARTY instructed them to sign various documentation which was "simply necessary to effect the continuing reliance and trust by Plaintiffs and Defendant CARTY"; that MR. CARTY specifically advised them in the context of having them sign certain documents and in the context of the continuing relationship of trust and confidence, that the documents did "not affect legal rights", that it was "not necessary that they be read", and, that they were "not provided any substantial opportunity to read any such documents", nor were they "advised of any contents thereof"; that at the time of the various meetings between they and MR. CARTY where documents were requested to be signed, MR. CARTY specifically represented in the context of their pre-existing relationship of trust and confidence that the documents "did not affect legal rights and it was not necessary to read them", that the documents were "only a formality" and that **ROBERT** and **BETTY** relied upon these representations by MR. CARTY and reposed their trust and confidence in him because of their pre-existing relationship; that these representations by MR. CARTY were false; that MR. CARTY knew them to be false and that they were made with the intent to deceive and defraud **ROBERT** and **BETTY** and to induce them to act in the manner alleged; and, that they were ignorant of the falsity of MR. CARTY'S representations and believed them to be true and in reliance upon his representations, did act in accord with his requests including the signing of the documentation and the transference of their retirement money to him.

The *facts* are as delineated above. At no time have Petitioners ever disputed, under oath, any of the facts set forth. They present no contrary *evidence* to this Court, nor have they to any other Court.

ARGUMENT

I.

THE DECISION OF THE CALIFORNIA COURTS ARE CORRECT

The decision of all three levels of California Courts (Superior, Court of Appeal and Supreme) are predicated on the undisputed facts set forth above. Unlike any case cited by Petitioners, the instant matter involves a circumstance of a pre-existing fiduciary relationship where Respondents were solicited by Petitioners. The record contains ample factual support for the unanimous California Court findings of fraud in the inducement of the arbitration agreement; a fraud that also exists with the balance of the relationship. As enunciated by the Second District Court of Appeal:

> "That the misrepresentation may go to some or even all of the clauses of the contract as well as the arbitration clause does not mean that fraud in the making of agreement for arbitration is not in issue. PRIMA PAINT does not stand for the proposition that a fraudulently induced arbitration agreement becomes valid and enforceable if the fraud also goes to other parts of the contract. PRIMA PAINT simply interpreted section 4 of the Act as requiring the arbitration provision of the contract to be treated as a separate agreement for the purpose of determining whether it is enforceable.
>
> The fraud alleged in PRIMA PAINT concerned misrepresentation of a party's financial condition. In contrast to the instant case, there was no allegation in PRIMA PAINT that a party was misled as to the existence or effect of the arbitration clause. Here, it is alleged that the parties were misled as to the very existence of the arbitration clause." (18 Cal.App.4th 802, 810).

The California Courts have thus unanimously held that Respondents herein have presented uncontroverted evidence of fraud in the inducement in the arbitration agreement. Petitioners have not once presented any evidence to the contrary. Ample evidence exists in the record to support the determination of the California Courts.

Since the determination of all three levels of California Courts were based on uncontroverted evidence, the true thrust of the Petition is simply a request to have this Court review evidence or review inferences drawn from that evidence. This Court properly denies certiorari in such a circumstance *(General Talking Pictures Corp. v. Western Electric Co.* (1938) 304 U.S. 175, adhered to in 305 U.S. 124, reh den 305 U.S. 675; *NLB v. Pittsburgh SS Co.* (1951) 340 U.S. 498).

II.

THE DECISION OF THE CALIFORNIA COURTS ARE NOT "FINAL" AND ANY DETERMINATION BY THIS COURT WOULD BE PREMATURE

Petitioners contend that the issue of arbitration has been conclusively determined against them by the California Courts. That conclusion is simply in error. The first sentence of the Discussion portion of the Opinion of the California Court of Appeal is as follows:

> "Our task on appeal is simply to determine whether the Plaintiffs have alleged in their complaint and affidavits sufficient facts to warrant a trial on the validity of the arbitration agreement. (Citations omitted)" (18 Cal.App.4th 802, 805).

The Petition to this Court does not follow a final determination either in favor of or denying arbitration; nor is it a Petition following an evidentiary hearing.

Unless Petitioners are prepared to accept the state of the evidence as uncontroverted, then Petitioners must acknowledge that procedurally they have been granted the right by all three levels of the California Courts to an evidentiary hearing on the issue of fraud in the inducement (9 U.S.C. Section 4). That Petitioners have this right is supported by the California authorities *(Strotz v. Dean Witter Reynolds, Inc.* (1990) 223 Cal.App.3d 208, ftnt 2 cited with approval by the Court of Appeal in the instant matter.

This Court has previously determined that California law in regard to addressing procedures of implementation of arbitration, even under the Federal Arbitration Act is proper; and that this Court will defer to the implementation of the arbitration procedures under California law in such a circumstance *(Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford, Jr. University* (1989) 489 U.S. 468). Unless Petitioners are prepared to concede the uncontroverted evidence, a concession they do not make in their Petition, then Petitioners must concede that their Petition is premature since the evidentiary hearing contemplated under 9 U.S.C. Section 4 and its implementation in California pursuant to *Strotz,* supra, and *Main v. Merrill Lynch Pearce Fenner & Smith, Inc.* (1977) 67 Cal.Ap.3d 19, 24 has not yet occurred nor has it yet been requested by Petitioners.

III.

THE CASES CITED TO SUPPORT THE PETITION ARE DISTINGUISHABLE

Each and every case cited by Petitioners to support their Petition have at their core an arms length, non fiduciary, business relationship. As enunciated by the Court in *Cohen*

v. Wedbush Noble Cooke, Inc. (9th Cir. 1988) 841 F.2d 282:

> "We know of no case holding that parties *dealing at arms length* have a duty to explain to each other the terms of a written contract. We have declined to impose such an obligation . . ." (Id at page 287) (Cited by the Court of Appeal in the instant matter at 808. (Emphasis Added).

The Federal Arbitration Act does not pre-empt the totality of state law. (*Volt,* supra). While this Court has recognized a national policy favoring arbitration (*Southland Corp. v. Keating* (1984) 465 U.S. 1), this Court likewise has determined that enforceability of arbitration provisions governed by the Federal Arbitration Act does not exist if grounds for revocation 'exist at law or in equity for the revocation of any contract'. (*Southland Corp. v. Keating,* supra). The California Courts have held that the relationship of the parties such as in the instant matter are not "arms length" but instead are in the nature of fiduciary relations and governed by those substantive rules (*Strotz,* supra; *Main v. Merrill Lynch Pearce Fenner & Smith, Inc.* (1977) 67 Cal.App.3d 19; *Twomey v. Mitchum Jones and Templeton, Inc.* (1968) 262 Cal.App.2d 690; *O'Neil v. Spillane* (1975) 45 Cal.App. 2d 147).

As stated in *Main,* supra:

> "When a fiduciary enters into a transaction with a beneficiary whereby the fiduciary's position is improved, or he obtains a favorable opportunity, or whether he otherwise gains, benefits, or profits, it may fairly be said that an advantage has been obtained (Citations omitted) . . . It is the settled law of this state, and elsewhere, that where there exists a relationship of trust and confidence, it is the duty of one in whom the confidence is reposed to make full disclosure

> of all material facts within his knowledge relating to the transaction in question and any concealment of material fact is fraud. (Citations omitted) Where there is [such] a duty to disclose, the disclosure must be full and complete, and any material concealment or misrepresentation will amount to fraud sufficient to entitle the party injured thereby to an action." (Citations omitted) (Id, 67 Cal.App.3d at 31-32)

While acknowledging *Prima Paint v. Flood and Conklin* (1967) 388 U.S. 395 (not a stockbroker/fiduciary relationship case but rather an arms length business transaction), the Court in *Main,* supra, made clear that where there is a confidential/fiduciary relationship, then those rules will govern the transaction. In the instant matter, the undisputed facts are that such a confidential/fiduciary relationship existed, not just as a matter of California law but as a factual matter as between the parties. The Court of Appeal in the instant matter makes clear that the nature of that relationship, and indeed its existence, is what Petitioners are entitled to have presented to a jury, should they choose, in determining whether or not the arbitration clause is to be enforced. As stated by the Court of Appeal in the instant matter:

> "In *Cohen* the court assumed the parties were dealing at arms length. The case did not discuss whether *Wedbush* was acting in a fiduciary capacity. Where a person reposes trust and confidence in another and the person in whom confidence is reposed obtains control over the other persons' affairs, a fiduciary relationship is created (citations omitted). Here the Lynches allege that Carty obtained control over their funds through the trust and confidence they reposed in him as a friend and a purported expert in investments. The Lynches also alleged that Carty was acting as the agent of Cruttenden and Sutro. This is sufficient to allege that the

> Defendants were acting in a fiduciary capacity." (Id at 808-809).

Thus, the uncontroverted evidence supports the finding and inferences of the confidential and fiduciary relationship. Not one single case cited by Petitioners herein arises out of, addresses, or concerns such a relationship.

IV.

CALIFORNIA STATE LAW IS NOT TOTALLY PRE-EMPTED BY THE FAA AND AN INDEPENDENT STATE GROUND EXISTS FOR THE CALIFORNIA DETERMINATION

This Court has previously held that the Federal Arbitration Act is not all inclusive and all pre-emptive. (*Volt Information Services, Inc.,* supra) In accord are the California cases (*Ford v. Shearson Lehman/American Express, Inc.* (1986) 180 Cal.App.3d 1011; *Rice v. Dean Witter Reynolds, Inc.* (1991) 235 Cal.App.3d 1016; *Main v. Merrill Lynch Pearce Fenner & Smith, Inc.,* supra), all citing with approval *Southland v. Keating,* supra, where this Court stated:

> "Such clauses may be revoked upon grounds as exist at law or in equity for the revocation of any contracts."

The three levels of California Courts in the instant matter unanimously have determined that under California law sufficient uncontroverted factual allegations have been presented so as to require an evidentiary proceeding to determine the existence and nature of the fiduciary and confidential relationship and fraud therein as to the arbitration agreement. (Petition Appendix 10A-11A) This finding is in accord with the Federal Arbitration Act and this Court's determinations in *Southland,* supra, and *Perry v. Thomas* (1987) 482 U.S. 483, 493, ftnt 9. No federal cases have been presented by Petitioners to the contrary, and the

area of law not being universally and completely pre-empted by the Federal Arbitration Act, the California Courts have properly applied state substantive law concerning fiduciary and confidential relationships. These findings are properly left intact. This Court from the time of its foundation has adhered to the principle that it will not review judgments of state Courts that rest on adequate and independent state grounds. (*Herb v. Pitcairn* (1945) 324 U.S. 117; *Williams v. Georgia* (1955) 349 U.S. 375; *Wolfe v. North Carolina* (1960) 364 U.S. 177; *Henry v. Mississippi* (1965) 379 U.S. 443).

V.

ADDITIONAL ISSUES

If this Court grants the Petition, it is respectfully requested that this Court consider the following additional issues:

A. WHETHER THE UNILATERAL IMPOSITION OF ARBITRATION CLAUSES IN THE SECURITIES INDUSTRY HAS BECOME UNCONSCIONABLE.

When this Court originally considered arbitration clauses in the securities industry, the provisions for arbitration and their implementation were in an embryonic stage. Now, the requirements of arbitration are near universally contained in Securities Industry standard preprinted forms. In its headlong rush to eliminate the ability of the American public to have access to Court's of law, the securities industry, which controls the financial heart of this country has unilaterally mandated securities industry controlled and implemented arbitration.[7]

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[7] See 27 Willamette Law Review (Summer 1991) 69 ftnt 50 stating that the results of their informal survey revealed one hundred percent (100%) of the leading brokerage houses polled require pre-dispute

California Courts have held that such standardized contracts, imposed and drafted by a party of superior bargaining strength (clearly existing in the instant matter and now existing on an industry wide basis to the entirety of the population of this country) constitute adhesion contracts *(Neal v. State Farm Insurance Companies* (1961) 188 Cal.App.2d 690, 694) and have further held that if unconscionable then they are unenforceable unless there is a meaningful choice of reasonably available alternative sources of supply *(Dean Witter Reynolds v. Superior Court* (1989) 211 Cal.App.3d 758). This issue was presented by Respondents at the trial Court, Court of Appeal and Supreme Court. None of the California Courts have reached the issue because they determined the Petitions to Compel Arbitration were properly denied factually, there being no substantive evidence in opposition thereto, pending a full evidentiary hearing. If this Court accepts the Petition, it is requested that this Court visit the issue of whether or not the pervasiveness of the unilaterally imposed and drafted arbitration clauses by the entirety of the securities industry constitute adhesion contracts that now are properly required to be conscionable both in their imposition and terms.

Securities Industry arbitration agreements in order to open new margin accounts. The undisputed record before the trial court in the instant matter is that in excess of ninety percent (90%) of all brokerage houses actually surveyed in 1989 have the standard industry arbitration provisions within their account documentation. This fact is further borne out by the failure of Petitioners, at the trial Court level, the Court of Appeal level, the California Supreme Court level, or indeed, in their Petition, to even suggest that there are meaningful alternatives available to the public. A member of the public cannot buy stocks or bonds without signing provisions eliminating rights to trial in a Court of law.

B. WHETHER OR NOT THE SECURITIES INDUSTRY IMPOSED ARBITRATION HAS BECOME UNCONSCIONABLE IN ITS IMPLEMENTATION.

When this Court visited the issue of securities arbitration and embraced it generally, the evidence did not exist, nor had there been any studies as to what was actually occurring in the securities arbitration proceedings. There have since been studies, both formal and informal, concerning the fairness, legitimacy and efficacy of the industry sponsored and controlled customer arbitration process. In the instant matter, since the Petition to this Court is premature, no evidentiary record has yet been made though the issue has been presented by Respondents from inception of the proceedings.[8]

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[8]In this regard, a recent article in the Los Angeles Times Business Section, Section D, on November 8, 1993 discussed the securities arbitrations and noted that the particular brokerage firm (Prudential Securities) was "making false statements to arbitrators, refusing to produce documents and postponing or drawing out hearings to increase the legal expenses of customers" and importantly:

> "The incidence show the flaws inherent in any customer arbitration case involving a brokerage firm. Debra Masucci, the head of the National Association of Securities Dealers confirmed that **THERE IS NO NASD RULE THAT PROHIBITS FIRMS FROM MAKING FALSE STATEMENTS IN ARBITRATION CASES.** She said that although such conduct could be considered a violation of the NASD's general ban on unfair conduct, she said she believes no such case has ever been brought." (Emphasis added).

As referenced in the article, one of the firms involved in representing Prudential Securities, the brokerage firm which may have made false or incorrect statements to the Arbitration Panel is the firm of Keesal, Young & Logan, counsel for Petitioners herein. Additionally, there have been federal studies concerning arbitration by the United States General Accounting Office including the May 19, 1992 concerning Securities Arbitration and Investors (GAO/GGD 92-71, May 11, 1992) and the study of employment discrimination and how registered representatives fare in industry controlled arbitration (GAO/HEHS-94-17 Employment Discrimination, March 30, 1994). Both studies delineate signifi-

VI.

CONCLUSION

For the above stated reasons it is respectfully submitted that the petition be denied.

DATED: June 8, 1994

Respectfully submitted,

PETER A. GOLDENRING, ESQ.
GOLDENRING, DEBBAS & PROSSER
A Professional Law Corporation
Attorneys for Respondents
Robert A. Lynch, Betty A. Lynch
individually and as Trustees of
the Robert A. Lynch and Betty
Laverne Lynch Family Trust
Dated May 30, 1979

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cant flaws in the arbitration process, flaws inuring to the benefit of the securities industry and the brokerage firms.

DECLARATION OF ROBERT A. LYNCH

I, ROBERT A. LYNCH, declare:

1. I am a resident of the County of Ventura, State of California and am over the age of eighteen years. If called as a witness I could and would testify competently stated hereinbelow. I am, individually, and as a trustee, a Plaintiff in the above-entitled action.

2. My date of birth is November 26, 1929. I am 62 years old. I have been married to my wife, BETTY LAVERNE LYNCH, for forty four (44) years.

3. I only attended school to the ninth (9th) grade. I did not graduate high school. I have not attended any colleges. I do not have any degrees or special training from any institutions of higher learning.

4. Prior to meeting MR. ROBERT CARTY, Defendant, and prior to his misdeeds which are the subject of the litigation now pending, I never had a securities account at any brokerage house or any other institution. Indeed I never, prior to meeting MR. CARTY, ever executed any stock broker agreements, brokerage house agreements or any other agreements of the type alleged to exist by the Defendants.

5. I first had contact with MR. CARTY in approximately 1988. I met MR. CARTY through his brother in Santa Barbara from whom we were purchasing a car owned by MR. CARTY. In the context of that brief transaction, I now see, in retrospect, the beginning of what became a massive fraud upon me and my wife, taking from us much of our retirement and security. As I look back, I now see what was not clear at the time: MR. CARTY carefully and precisely manipulated himself into becoming what we believed to be a very close friend and confidante. MR. CARTY, through his careful manipulative schemes, encouraged me to repose in him the highest degree of trust

and confidence, and caused our relationship to be such that he was trusted absolutely and unquestioningly.

6. MR. CARTY, in the context of our acquisition of the car through his brother, first started talking to me in general terms about business. He, in the course of these initial discussions, presented himself as being associated with well established multi-generational Ventura County families with whose names I was well familiar. MR. CARTY explained that his grandfather was closely associated with and personal friends with Martin Smith, the well known Oxnard developer. MR. CARTY also told me that he was married to the daughter of Mr. Ted Engs, of Engs Peterbilt — another well-established Ventura and Los Angeles County family. In this context, MR. CARTY explained his business. What MR. CARTY told me was that much like Mr. Smith knew how to develop property and Mr. Engs knew how to sell and maintain trucks, MR. CARTY knew how to manage people's money safely and prudently. MR. CARTY explained in the beginning of our relationship and repeated throughout the relationship, that he was an expert in safely managing people's money and that he had the trust and confidence of many successful people — again alluding to his family relationships with Mr. Smith and Mr. Eng.

7. At the beginning of the relationship, MR. CARTY presented himself as someone who wanted to become a personal friend. He did not specifically discuss managing or taking care of our retirement funds or money. Instead he spent considerable time befriending himself to me. He would come by my office or house as often as two (2) times per week. He would, from time to time, take me to lunch, including lunch at the Tower Club at the top of the Union Bank Building. We would sit at what MR. CARTY described as "Mr. Smith's private table".

8. In the course of these many conversations, long before

MR. CARTY obtained possession of our funds, I would tell MR. CARTY that I had no experience in stocks, no experience in bonds, no experience in mutual funds or any other kind of activity that he was describing. I told him I was "completely green" and had no prior experience and thus did not understand most, if not all, of what he was discussing. MR. CARTY would, on those occasions, again reiterate that managing money safely was his business and that's what he was an expert in, while other people had other aspects of business with which they were successful.

9. In the course of what was, I thought at the time, a developing close friendship, I related to MR. CARTY that in essence I was self made. I had built, from scratch, a cement business which involved the selling of cement. I also related to MR. CARTY, as time passed, that there was a buyer interested in buying the business and that my wife and I were very seriously considering selling the business, paying the taxes and then putting away what was left in safe investments for our retirement and our children. MR. CARTY, I now can see in retrospect, become extremely solicitous at the point in time I mentioned the sale of the business. Indeed, in retrospect I can see that he substantially increased his subtle, but very effective, pressure toward increasing friendship and trust.

10. Finally, the business was sold and the taxes paid. Our share sale proceeds was approximately Five Million Dollars ($5,000,000.00) before taxes. Certainly this amount of money was not insubstantial and I recognized that it needed to be carefully, prudently and safely invested for my future, my wife's future and our children. In this context, MR. CARTY asked me, as a friend, to become the manager of these funds for my wife and my family.

11. At the time we had the funds from the sale of the business in our possession, we discussed with MR. CARTY, his suggestion and request that he become, as a friend, the

manager of our family's future. I explained to MR. CARTY that it was absolutely essential that the funds be carefully, prudently and safely managed. I explained to MR. CARTY that, in essence, I was unwilling to take any risk that would put in jeopardy in any significant form, the principal of our funds which were the future of our retirement and inheritance to our children. I told MR. CARTY that safety was critical in any money management that he would undertake. I again reiterated to MR. CARTY that I had absolutely no prior experience at all in dealing with brokerage houses, stock brokers, stock, bonds, or any of the other things that he would talk about as his "business and profession". MR. CARTY told my repeatedly and in the context of these discussions that I should trust him, that I could trust him, and that I should rely upon his expertise and management skills both as a friend and as a professional.

12. After these discussions with MR. CARTY, I agreed that he would become our family's money manager in the context of preserving the funds for the future, while at the same time, accumulating interest so that it would grow toward our retirement and ultimately, the inheritance for our children. In this context, MR. CARTY came to my wife and I and told us, as we were having the funds transferred to him, that he needed some "form" documents signed in order to open the account. MR. CARTY told me that the documents we needed to sign were "standard" and were "simply a formality" to open the account to effect the transfer of the funds to him for safe management. He told me, in sum and substance, that it was not necessary to read the documents since they simply effected an opening of the account and the transference of the funds to him. In this context, MR. CARTY repeatedly stressed that I could trust him. On that basis and trusting MR. CARTY as a friend, which he knew and encouraged, I signed then and throughout the relationship whatever documents MR. CARTY put in front of me from time to time. I did not read the documents and was

discouraged from doing so by MR. CARTY. Indeed, MR. CARTY knew that I probably would not have understood them even if I had read them. MR. CARTY told me repeatedly each time documentation was brought to us to sign, that they were simply forms, tax papers or formalities that were "standard" and needed to be signed for the continuing management of our family funds by him. Indeed, over the history of our relationship with MR. CARTY, he would, at various times, come to us to have us sign documentation. Each time he would do so he would reiterate the closeness of our friendship, reiterate his expertise and skill in managing money and, indicate that he simply needed "our signature" on a "standard" document that was a "formality" so that he could continue to manage our retirement and family monies safely and prudently.

13. At no time, ever, in the course of any conversation with MR. CARTY or anyone else was I ever told that the documentation MR. CARTY was having me sign, which he said was "standard" and a "formality" contained an arbitration clause. At no time did MR. CARTY or any other person on behalf of any Defendant in this action ever advise me that the "standard" and "formality" documentation that he was having me sign without reading contained any limitation on rights of recovery. At the time MR. CARTY had me sign documentation of any sort, I was told they were "standard" and "formality", I was not told that the documents actually constituted a contract and that there were any terms which would be deemed to be terms of a contract so as to limit any rights that I might have. If I had known and understood the arbitration clause no sought to be enforced by Defendants, and about the limitation of my rights of recovery contained in the arbitration clause, I would not have executed the documents.

14. As a result of the mismanagement of our retirement and family funds by MR. CARTY, the funds have been

substantially dissipated. Indeed, it is now my understanding that we have lost well over one-half (½) of our funds directly from the mismanagement, churning and improper handling of our funds by MR. CARTY and the brokerage houses with which he worked. At the same time, I now believe that in fact commissions were generated to MR. CARTY and the brokerage house, as best I can tell, somethere close to or in excess of One Million Dollars ($1,000,000.00). Our hoped for retirement and future has now turned into an absolute nightmare.

15. I have had an opportunity to review the declarations that have been presented by the Defendants in this matter. The following matters are respectfully submitted to this Court:

(a) The claim by MR. CARTY of his denial of Paragraphs 11 and 14 of the Complaint is untrue. MR. CARTY affirmatively and specifically discouraged any reading of documents repeatedly referring to our "friendship" and the level of trust that had developed. Indeed, I have a specific recollection that at one time when MR. CARTY told me I needed to sign a document the following conversation took place, in sum and substance:

> "CARTY: These are the documents I need for you to sign so I can manage your money for you. Don't worry about the documents, they're formalities, just go ahead and sign them."
>
> ROBERT LYNCH/BETTY LYNCH: Okay — we trust you.
>
> ROBERT LYNCH: (Jokingly) I hope I am not signing my life away.
>
> CARTY: (Laughing) No — they're just a formality, they're not important."

(b) I have read the declaration of Marilyn France. I have never spoken with Marilyn France. I have never met Marilyn France. If she walked into a room in which I was sitting, I would not know who she is. I have never received a letter from Marilyn France.

16. I ask this Court to permit us to remain in this Court and present our grievances before twelve (12) members of our community.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 12 day of February, 1992 at Ventura, California.

ROBERT A. LYNCH

DECLARATION OF BETTY LAVERNE LYNCH

I, BETTY LAVERNE LYNCH, declare:

1. I am a resident of the County of Ventura, State of California and am over the age of eighteen years. If called as a witness I could and would testify competently to the matters stated hereinbelow. I am a Plaintiff, individually and as trustee, in the above-referenced litigation.

2. My date of birth is May 9, 1930. I am 61 years of age. I graduated high school in 1948. I have never had any college education. After high school I attended a trade school to learn shorthand and typing.

3. I have reviewed the declaration of my husband, ROBERT A. LYNCH, filed concurrently herewith. It is true and correct in its entirety.

4. Most of our funds for retirement and for passing on to our children have now been lost due to MR. CARTY and his improper conduct. I was present when various of the conversations between MR. CARTY and my husband took place concerning the documents. MR. CARTY repeatedly told us that any document papers were simply "formality" so that he could "manage our money". He referred to the forms as "standard forms" or "standard documents" that were "formality" and that we did not need to worry about them or what they said.

5. I also remember the specific conversation with MR. CARTY at one point when documents for our signature were being presented and I specifically remember MR. CARTY stating, "These are things that need to be signed for him to continue to manage the funds. Don't worry about them, just sign them." I also specifically recall my husband jokingly commenting, as he was signing, "I hope I am not signing my life away" and MR. CARTY laughing and saying, "No — they're just a formality and they're not important."

6. At no time would I have executed documents if I had known they contained a limitation on my legal rights as now asserted by Defendants. For MR. CARTY to state, as he does in his declaration that he did not tell us that we didn't need to read the documents, that they did not affect our legal rights or, that they were just "formality" and "standard" is an absolute lie by him.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on this 12th day of February, 1992 at Ventura, California.

BETTY LAVERNE LYNCH

DECLARATION OF JAN CORWIN LINDSAY

I, JAN CORWIN LINDSAY, declare:

1. I am a resident of the County of Ventura, State of California. I am over the age of eighteen years and if called as a witness could and would testify competently to the matters stated hereinbelow.

2. I am a Certified Public Accountant in the State of California and have been so certified since 1973. I have, on a number of occasions testified before the Superior Court of the State of California for the County of Ventura on various matters as an expert witness.

3. At the request of Peter A. Goldenring, counsel for Plaintiffs, I made inquiry to various sources, including the board of governors of the federal reserve system, as well as various other publications available to Certified Public Accountants on certain economic issues relevant to this action. My findings, on specific inquiries by Mr. Goldenring are delineated below.

4. The first question I was asked by Mr. Goldenring was, as best as could be determined from generally available public information for accountants and economists what were the total number of offices of the top twenty five (25) brokerage firms in the United States. I determined that the most current data in this regard that could be obtained was as of January 1, 1989. Total offices for retail outlets for brokerage firm as of that date was three thousand three hundred fifty one (3,351).

5. The next question I was asked was for a ranking of the top six (6) brokerage firms in terms of number of offices. The ranking is as follows:

Brokerage Firm	Number of Offices
Dean Witter	692
Shearson Lehman	613

Brokerage Firm	Number of Offices
Merrill Lynch	550
A.G. Edwards	368
Prudential Bache	336
Paine Webber	296
Oppenheimer	78
Total	2,933

Accordingly, of the total of three thousand three hundred fifty one (3,351) offices, the top seven (7) brokerage firms comprise two thousand nine hundred thirty three (2,933), for a total of eighty seven percent and one-half (87½%).

6. I was asked, in terms of the number of registered representatives (stock brokers) the total number in the industry, as well as the ranking for the top seven (7) brokerage houses. I determined that as of January 1, 1989, the most recent data I was able to locate, the total number of brokers was fifty eight thousand three hundred eight three (58,383). The ranking of the top seven (7) brokerage houses was as follows:

Brokerage Firm	Number of Brokers
Merrill Lynch	12,600
Shearson Lehman	11,284
Dean Witter	7,725
Prudential Bache	5,876
Paine Webber	4,595
A.G. Edwards	3,402
Oppenheimer	688
Total	46,170

Of the total number of registered representatives of fifty eight thousand three hundred eight three (58,383), the top seven (7) brokerage houses total forty six thousand one hundred seventy (46,170) for a total of seventy nine and eight one hundredths percent (79.08%).

7. The information and data relied upon by me was obtained from industry survey data issued by the securities industry and published by them.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 12th day of February at Ventura, California.

JAN CORWIN LINDSAY

DECLARATION OF PETER A. GOLDENRING

I, PETER A. GOLDENRING, declare:

1. I am an attorney licensed to practice law in the State of California and am a member of the law firm of Goldenring and Goldenring, A Professional Law Corporation, counsel of record for Plaintiffs herein. If called as a witness I could and would testify competently to the matters stated hereinbelow.

2. This Court has before it a request by Defendants to remove Plaintiff and their claims from the judicial system and place them in an arbitration process that is controlled and regulated by the securities industry itself. In other words, this court is being asked to place its stamp of approval on sending Plaintiffs into the den of wolves where they are to receive "justice."

3. The following facts are relevant for this Court's determination:

(a) As set forth in the Memorandum of Points and Authorities, there are essentially two (2) grounds upon which this court properly denies the Petition. The first and most direct is pursuant to *Strotz v. Dean Witter Reynolds* (1990) 223 Cal. App. 3d, 208, 207 Cal. Rptr. 680. It is clear under that case that arbitration in the instant matter is simply inappropriate and precluded as a matter of law.

(b) The second ground upon which this Court should deny the Motion to Compel Arbitration is under California's law governing adhesion contracts. As discussed in the memorandum of Points and Authorities following, it is California law, not federal law, which governs the enforceability of the subject contract. It is California law, not federal law, which measures whether or not the contract is an adhesion contract and, then upon that finding, determines whether or not the specific provision to arbitrate will be enforceable as a matter of public policy. California law as set forth in the

Memorandum of Points and Authorities hereafter, articulates quite clearly that when a consumer has no choice of any significance in the industry, that lack of choice, through effectively an anti-trust analysis, precludes enforcement of the "adhesion contract".

4. In the instant matter, the Defendants in their Motion and presumably in their Reply, will go to great lengths to discuss federal law. It is important to note that the federal laws cited all predate what has most recently, within the last two (2) years, occurred in the securities industry. Within the last two (2) years, the securities industry as a whole and nearly uniformly, has included in its "standard account documents", arbitration clauses. The arbitration clauses from the various brokerages are astroundingly identical in their language. Moreover, the entire brokerage securities industry has now adopted a posture that the "arbitration provision" is included in its standard documents. Thus, any member of the public wishing to open or maintain a securities brokerage account, be it for a money market fund, putting in securities inherited from grandma, or any other purpose, must effectively waive all access to the Judicial Courts of the State of California. While it is not possible to present to this Court every single "standard" contract by a brokerage house, a majority are presented herewith, representing well over ninety plus percent (90+%) of the stock brokers and offices of stock brokers in the State of California and indeed, the Country, as follows:

(a) Paine Webber Client Agreement, Exhibit A attached hereto and incorporate herein by this reference. The Paine Webber arbitration clause is paragraph 19.

(b) Merrill Lynch Pierce Fenner and Smith. A true and correct copy of the Merrill Lynch Pierce Fenner and Smith Open Account documentation is attached hereto marked Exhibit B and incorporated herein by this reference. The arbitration clause in this document is paragraph 11.

(c) Shearson Lehman Brothers. A true and correct copy of the Shearson Lehman Brothers "Client Agreement" is attached hereto, marked Exhibit C and incorporated herein by this reference. The "arbitration clause" is paragraph 23.

(d) Prudential-Bache Securities. A true and correct copy of the Prudential-Bache client opening account agreement is attached hereto and marked Exhibit D and incorporated herein by this reference. The arbitration agreement in the Prudential-Bache document is paragraph 11.

(e) Dean Witter Reynolds, Inc. A true and correct copy of the Dean Witter Reynolds, Inc. Customer Agreement is attached hereto, marked Exhibit E and incorporated herein by this reference. The arbitration provision is set forth in paragraph 13 of this document.

(f) A.G. Edwards & Sons, Inc. A true and correct copy of the A.G. Edwards & Sons, Inc. Customer Agreement is attached hereto, marked Exhibit F and incorporated herein by this reference. The arbitration agreement is contained in paragraph 7 of the A.G. Edwards documentation.

(g) Oppenheimer & Company, Inc. A true and correct copy of the Oppenheimer & Company, Inc. "Client Agreement" is attached hereto, marked Exhibit G and incorporated herein by this reference. The arbitration provision is contained at paragraph 26 in this document.

5. The Court will note that with uniformity each and every brokerage house has, in its "standard" documentation an arbitration agreement. The Court will also note that the arbitration agreement languages are essentially identical and indeed, the arbitration language that the Defendant seeks to enforce herein is essentially identical to the language in the Exhibits referenced.

6. Throughout the Petition and Motion to Compel Arbitration filed by the Defendants, there is the implied claim that the "arbitration" is a fair and evenhanded procedure.

This is simply not the case and indeed, the arbitration as proposed is so one-sided as to constitute a complete abrogation of the rights of Plaintiff. The true facts concerning the arbitration are as follows:

(a) The arbitration clause sought to be enforced effectively contains within it, without disclosure, a limitation on rights of recovery and the ability of the arbitrators to award damages. Under New York Law governing these agreements, punitive and exemplary damages are generally not recoverable. The arbitration clause Defendant seeks to enforce and indeed, the arbitration clauses uniformly, do not disclose this limitation of rights. Thus, damages for willful misconduct and intentionality are precluded. This is significant for, under California Law, as set forth in the Memorandum of points and Authorities attached hereto, the stock broker (Defendant CARTY) and the brokerage houses are fiduciaries to Plaintiff, standing in the highest degree as that term and relationship. (See *Twomey v. Mitchum, Jones & Templeton, Inc.* [1968] 262 Cal. App. 2d. 690, 69 Cal Rptr. 22).

(b) Under the terms of the arbitration clause sought to be enforced, whichever one it might be, the arbitration is to take place before one of the securities organizations and trading forums such as the New York Stock Exchange (NYSE), or, under the auspices of the National Association of Securities Dealers (NASD). Of course, this Court is well familiar with the Exchanges, such as the New York Stock Exchange and the American Stock Exchange. The National Association of Securities Dealers is an association of stock brokers and brokerage houses, by stock brokers and brokerage houses, and for stock brokers and brokerage houses.

It is noteworthy that in drafting the arbitration clause sought to be enforced by Defendants herein, and indeed in all of the arbitration clauses that are used industry-wide as set forth in the Exhibits, not a single brokerage house

includes the American Arbitration Association (AAA) or any other independent tribunal. The only arbitration tribunals permitted under the proposed arbitration clause and in the industry's arbitration clauses now universally imposed upon members of the public are industry-controlled entities.

7. With respect to the arbitration as governed by the NYSE or the NASD, there is absolutely no provision for any enforceable discovery. While there are certain "voluntary" exchanges of documents, no depositions are permitted, no compelling of documents prior to proceedings can effectively occur and indeed, none of this discovery ever takes place in the industry-sponsored arbitration forum. Given that circumstances, Defendants have all the information and Plaintiff none. The right to discovery is critical for Plaintiffs. Indeed, as is the case now across the board in the industry, the industry is effectively seeking to preclude discovery of its workings and fraudulent practices on consumers by now attempting to force consumers, through the adhesion contract, into industry arbitration where no discovery is permitted. The attitude of the Defendants has already been exhibited. Your declarant has caused to be served on Defendants a request for deposition of corporate designee and production of documents thereat. These requests included designation of a corporate designee deponent on the subject matter of the arbitration agreements and their usage, as well as seeking production of pertinent documentation associated therewith. Defendants have refused to comply with this discovery, have advised that they will not attend the deposition and have categorically stated that the "requests" are in violation of the preclusion of discovery in the arbitration they seek to enforce.

8. Then, of course, the question need be asked, who are the arbitrators. The arbitrators, not surprisingly, consist of securities industry associated individuals. One of the three arbitrators must be an active securities representative. The

other two are defined as members of the "public". Yet, the definition of the "public" includes an individual who has been for his entire life in the securities industry but retired for at least three (3) to five (5) years. This is hardly a legitimate forum for arbitration. In the context of an adhesion contract, public policy must absolutely preclude enforcement of a one-sided arrangement as Defendant seeks to use on Plaintiffs and now in an increasingly broad spectrum, all members of the public.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 12th day of February, 1992 at Ventura, California.

PETER A. GOLDENRING